CANADA

National Energy Board

Reasons for Decision

Westcoast Energy Inc.

RH-2-89

January 1990

Tolls

National Energy Board

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Westcoast Energy Inc.

Application Dated 5 July 1989
for New Tolls Effective
1 January 1990

RH-2-89

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Recital and Appearances

IN THE MATTER OF the National Energy Board Act and the Regulations made thereunder; and

IN THE MATTER OF an application by Westcoast Energy Inc. for an order respecting tolls pursuant to Part IV of the National Energy Board Act; and

IN THE MATTER OF the National Energy Board Directions on Procedure in Order RH-2-89.

HEARD in Vancouver, British Columbia on 11,12,13,16,17,18,19,20,23 and 24 October, and in Ottawa, Ontario on 31 October and 1 November 1989.

BEFORE:

R.B. Horner, Q.C.	Presiding Member
D.B. Smith	Member
A. Côté-Verhaaf	Member

APPEARANCES:

J. Lutes R. Sirett	Westcoast Energy Inc.
J.B. Ballem, Q.C.	Canadian Petroleum Association
R.B. Wallace	Council of Forest Industries of British Columbia and Cominco Ltd.
A.S. Hollingworth	Independent Petroleum Association of Canada
A.A. Fradsham	Alberta and Southern Gas Co. Ltd.
D.M. Masuhara	BC Gas Inc. and Peace River Transmission Company Limited
J.M. Pelrine	British Columbia Petroleum Corporation
C.B. Woods	Mobil Oil Canada
W. Silk	Unocal Canada Limited
R.W. Graw M. Fowke	National Energy Board

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Abbreviations

AFUDC	Allowance for Funds Used During Construction
B.C.	British Columbia
BC Gas	BC Gas Inc.
BCPC	British Columbia Petroleum Corporation
BCPC Agreement	Westcoast/BCPC Agreement dated 13 November 1973
CAPM	capital asset pricing model
CBRS	Canadian Bond Rating Service
CCA	capital cost allowance
CD	contract demand
CGA	Canadian Gas Association
CICA	Canadian Institute of Chartered Accountants
COFI	Council of Forest Industries of British Columbia
Cominco	Cominco Ltd.
CPA	Canadian Petroleum Association
CPI	Consumer Price Index
DBRS	Dominion Bond Rating Service
DCF	discounted cash flow
FASB	Financial Accounting Standards Board
GPIS	gas plant in service
ICG	Inter-City Gas Corporation
IPAC	Independent Petroleum Association of Canada
long-Canada	long-term Government of Canada bond
NEB or the Board	National Energy Board
NEB Act or the Act	National Energy Board Act
Northwest	Northwest Pipeline Corporation

NPIS	net plant in service
OD	operating demand
O&M	operating and maintenance
PCEC	Pacific Coast Energy Corporation
RH-1-89 Westcoast Reasons for Decision	"National Energy Board Reasons for Decision dated September 1989 in the Matter of an application of Westcoast Energy Inc. dated 14 April 1989 for new tolls effective 1 November 1989"
RH-1-88 Phase II TransCanada Reasons for Decision	"National Energy Board Reasons for Decision dated June 1989 in the Matter of an application of TransCanada PipeLines Limited dated 5 February 1988 for Tolls"
RH-2-87 Westcoast Reasons for Decision	"National Energy Board Reasons for Decision dated November 1987 in the Matter of an application of Westcoast Energy Inc. dated 19 December 1986 for new tolls effective 1 January 1987 and 1 January 1988"
RH-3-86 TransCanada Reasons for Decision	"National Energy Board Reasons for Decision dated May 1987 in the Matter of an application of TransCanada PipeLines Limited dated 14 July 1986 for new tolls effective 1 January 1987"
RH-6-85 Westcoast Reasons for Decision	"National Energy Board Reasons for Decision dated August 1986 in the Matter of an application of Westcoast Energy Inc. dated 1 December 1985 for new tolls effective 1 January 1986"
TransCanada	TransCanada PipeLines Limited
Vancal	Vancal Properties Ltd.
Westcoast or the Company	Westcoast Energy Inc.

Overview

On 19 December 1989, the Board issued Order TG-9-89 (see Appendix I) and its Decision (see Appendix II) without the attendant Reasons for Decision in an attempt to avoid the requirement for interim tolls on 1 January 1990.

On 22 December 1989, Westcoast requested that the Board amend sections 4.7.3 and 6.1 of its Decision to reduce the amount of the deferral referred to in section 6.1 from $3,642,000 to $2,091,000. Westcoast explained that the balance in this deferral account was erroneously characterized by it as reflecting a change in the tax rate in 1988 and 1989 rather than a deferral of excess revenue from the 1989 to the 1990 test year (see Appendix V).

On 28 December 1989, the Board issued Order TGI-4-89 (see Appendix VI) making Westcoast's existing tolls interim, effective 1 January 1990 and suspending Order TG-9-89, pending a decision on Westcoast's application. On 9 January 1990, the Board approved the deferral of $2,091,000 and amended sections 4.7.3 and 6.1 of its Decision. The Board also issued amending Order AO-1-TG-9-89 (see Appendix VII) and directed Westcoast to file its new tolls with the Board by 15 January 1990.

Chapter 1

Background and Application

On 23 March 1989 the National Energy Board ("NEB" or "the Board") informed Westcoast Energy Inc. ("Westcoast" or "the Company") and interested parties that the examination of Westcoast's tolls for the 1989 and 1990 test years would be conducted in two hearings and directed Westcoast to file its evidence with respect to each hearing by 17 April and 30 June 1989, respectively. The Phase I hearing, which was held pursuant to Hearing Order RH-1-89, dealt with Westcoast's capacity allocation policy, self-displacement and other toll design and tariff issues. The Board's RH-1-89 Westcoast Reasons for Decision with respect to the Phase I hearing was released in October 1989. Conducted in accordance with the procedures set out in Hearing Order RH-2-89 (see Appendix III), the Phase II hearing was held to establish the revenue requirement for the 1990 test year and to determine the appropriate disposition of all deferral account balances.

Prior to the Phase I hearing, the Board advised Westcoast and interested parties by letter dated 9 January 1989 that the Board had set Westcoast's 1989 revenue requirement at $274.5 million for toll purposes. Subsequently, on 3 February 1989, the Board informed Westcoast and interested parties that it would not be necessary to examine Westcoast's toll design and tariffs for the period 1 January to 31 October 1989 and that tolls for the period 1 November 1989 to 31 December 1990 would be determined during the Phase II hearing.

Westcoast's Phase II application was filed on 5 July 1989 and was subsequently updated on 29 September 1989. The evidentiary portion of the hearing, which took 10 hearing days, commenced in Vancouver on 11 October 1989. Final argument was heard in Ottawa on 31 October and 1 November 1989.

At the commencement of the hearing, the Board solicited comments from interested parties on the tolls to be charged by Westcoast for the stub period, 1 November to 31 December 1989. There were two methods proposed for determining the tolls for the subject period. One method was to roll the stub period into the 1990 test year so that the final tolls would be determined on the basis of a 14-month test period. The other method, which was ultimately accepted by the Board, was to immediately set final tolls for the stub period based on the RH-1-89 Westcoast Reasons for Decision and the 1989 revenue requirement previously set by the Board and to work towards determining the final tolls for the 1990 test year prior to 1 January 1990. This approach would avoid the necessity for interim tolls as well as producing certainty in the tolls for the two periods under consideration. The Board's ruling was given from the bench on 19 October 1989 (see Appendix IV).

In furtherance of the Board's intention to avoid the need for interim tolls, on 19 December 1989 the Board issued Order TG-9-89 (see Appendix I) and its Decision (see Appendix II), without the attendant Reasons for Decision, respecting Westcoast's Phase II application and all other matters raised in connection with the RH-2-89 toll hearing. On 22 December 1989, Westcoast requested that the Board amend sections 4.7.3 and 6.1 of its Decision and reduce the amount of the deferral referred to in section 6.1 from $3,642,000 to $2,091,000. Westcoast explained that the balance in this deferral account had been erroneously characterized by it as reflecting a change in the tax rate in 1988 and 1989 rather than deferral of excess revenue from the 1989 to the 1990 test year (see Appendix V).

On 28 December 1989, the Board issued Order TGI-4-89 (see Appendix VI) making Westcoat's existing tolls interim, effective 1 January 1990, and suspending Order TG-9-89, pending a review of its decision. On 9 January 1990, the Board approved the deferral of $2,091,000 and amended sections 4.7.3 and 6.1 of its Decision. The Board also issued amending Order AO-1-TG-9-89 (see Appendix VII).

Chapter 2

Revenue Requirement for 1990

A summary of the approved revenue requirement for the 1990 test year, together with the Board's adjustments which reflect its Decision dated 11 December 1989, as amended and Board Orders TG-9-89 and AO-1-TG-9-89, is shown in Table 2-1. The reasons supporting the Board's adjustments are provided in Chapters 3, 4, 5 and 6.

Table 2-1

Transportation Revenue Requirement for the 1990 Test Year
($000)

	Application[1]	Application as Revised [2]	NEB Adjustments	Authorized by NEB
Operating and Maintenance:				
Salaries, Wages and Benefits	47,712	47,712	(181)	47,531
Other O&M Expenses	48,922	49,098	(128)	48,970
	96,634	96,810	(309)	96,501
Regulatory Costs	1,794	1,794	-	1,794
Depreciation	30,576	30,576	(11)	30,565
Amortization	(3,548)	(3,950)	4,494	544
Taxes Other Than Income Taxes	46,808	45,608	-	45,608
Miscellaneous Operating Revenue	(4,399)	(4,399)	-	(4,399)
Insurance Deductibles	167	167	-	167
Foreign Exchange on Debt	1,141	1,141	-	1,141
Gas Used in Operations	4,918	4,918	-	4,918
Income Tax Expense	21,742	22,491	1,082	23,573
Return on Rate Base				
at 12.18%	101,203			
at 12.11%		100,631	(100,631)	-
at 11.70%		-	96,649	96,649
Sub-Total	297,036	295,787	1,274	297,061
Deferrals	(4,327)	(4,272)	205	(4,067)
Total Revenue Requirement	292,709	291,515	1,479	292,994
Fixed Costs	283,734	282,539	1,480	284,019
Variable Costs	8,975	8,975	-	8,975
Total Revenue Requirement	292,709	291,515	1,480	292,994

1 Application dated 5 July 1989, as revised by Westcoast on 29 September 1989.
2 On 8 November 1989, Westcoast updated the application to reflect various changes based on matters raised during the hearing.

NOTE: Totals may not add due to computer rounding.

Chapter 3

Rate Base and Depreciation

A summary of the approved average rate base for the 1990 test year, together with the Board's adjustments which reflect its Decision dated 11 December 1989 as amended, is shown in Table 3-1. The reasons supporting the Board's adjustments are provided in sections 3.1 to 3.6.

3.1 Gas Plant in Service

3.1.1 Capital Additions Transferred to Gas Plant in Service

Westcoast projected that it would add an estimated $57.737 million to gas plant in service ("GPIS") in 1990.

Table 3-1

Average Rate Base for the 1990 Test Year
($000)

	Application [1]	Application as Revised [2]	NEB Adjustments	Authorized by NEB
Gas Plant In Service	1,461,083	1,461,082	(740)	1,460,342
Accumulated Depreciation	(594,658)	(594,658)	3	(594,655)
Net Plant in Service	866,425	866,423	(737)	865,686
Net Plant in Service Adjustment	(6,169)	(6,169)	5	(6,164)
Contributions in Aid of Construction	(4,051)	(4,051)	-	(4,051)
Plant Investment	856,204	856,203	(732)	855,471
Materials and Supplies	20,225	20,225	-	20,225
Line Pack Gas	3,615	3,615	-	3,615
Prepaid Expenses	(2,516)	(2,527)	-	(2,527)
Deferrals	16,770	16,798	(1,909)	14,889
Deferred Income Taxes	(71,687)	(71,489)	(2,244)	(73,733)
Average Rate Base Exclusive of Cash Working Capital	822,612	822,825	(4,885)	817,940
Cash Working Capital	8,281	8,148	(31)	8,117
Average Rate Base	**830,893**	**830,973**	**(4,916)**	**826,057**

1 Application dated 5 July 1989, as revised by Westcoast on 29 September 1989.
2 On 8 November 1989, Westcoast updated the application to reflect various changes based on matters raised during the hearing.

NOTE: Totals may not add due to computer rounding.

Intervenors did not take exception to the Company's estimate of capital additions for the test year. However, the Canadian Petroleum Association ("CPA") expressed concerns regarding projects that had been approved a number of years ago and still had not been completed and transferred to GPIS. CPA's concerns are addressed in section 3.1.3.

Views of the Board

The Board believes that only those projects that have received the Board's approval under Part III of the National Energy Board Act ("NEB Act" or "the Act") prior to the date of its Decision on 11 December 1989 should be approved for inclusion in the 1990 test-year rate base.

Decision

The Board directs Westcoast to remove from its applied-for 1990 GPIS the forecast amounts for those projects that have not received Board approval under Part III of the NEB Act by 11 December 1989.

The effect of this decision on average rate base is a reduction of $740,000.

3.1.2 Forecast of Test-Year Allowance for Funds Used During Construction

Decision

Westcoast is directed to calculate its forecast test-year allowance for funds used during construction ("AFUDC") to reflect the capital additions transferred to GPIS in accordance with the Board's decision in section 3.1.1, and the rate of return on rate base determined in accordance with the decisions set out in sections 4.1 to 4.6.

3.1.3 Adjustment to Forecast Gas Plant In Service

In its RH-2-87 Westcoast Reasons for Decision, the Board instituted the net plant in service ("NPIS") adjustment mechanism to respond to concerns that Westcoast's actual expenditures on capital additions had rarely equalled the Company's projected additions to rate base. The NPIS adjustment is based on a comparison of the actual and estimated net plant in service over a five-year period. Expressed as a percentage, the adjustment factor is applied to the test-year estimate of NPIS and the resulting amount is either added to or deducted from the projected NPIS in determining the test-year rate base. Based on this methodology, Westcoast proposed to reduce the test-year NPIS by 0.712 percent or $6,169,000.

CPA recognized that the NPIS adjustment mechanism was established to compensate for the inherent difficulty in forecasting capital additions to rate base. However, CPA maintained that the NPIS adjustment mechanism was inadequate because it did not recover depreciation or AFUDC on those projects that were not transferred to rate base in a given test year. CPA also expressed concern about a number of projects that were approved by the Board several years previously, but that were still incurring expenditures in 1989, or had expenditures forecasted in the future. For example, CPA cited projects that were approved in 1981 but were not forecast to be completed until some time in 1989. CPA also expressed the concern that if money were to be spent on a project that was not completed and put into service, Westcoast would continue to earn AFUDC on the expended funds.

Westcoast responded that the net plant adjustment does take into account variances in the depreciation provision. The Company also pointed out that the tollpayers receive the benefit of a decrease in the income tax allowance through the deduction of capital cost allowance ("CCA") on any excess capital addition forecasts.

In referring to the projects planned but not completed, CPA acknowledged the existence of the sunset clause, but suggested that it should be tightened up. The current sunset clause requires Westcoast to re-apply for approval of a project if the Company has not expended any funds on a specific project within a period of up to 24 months from the date of approval. In CPA's view, the fact that Westcoast is only required to commence expenditures (which can be a mere allocation of funds) within 24 months in order to preserve the status of the project makes it very easy to avoid the effect of the sunset clause as it is presently constituted. CPA recommended that the sunset clause be made more effective by requiring Westcoast to report on the status of each project which has not been completed within 24 months of approval, with reasons why the approval should not be rescinded.

Neither Westcoast nor any other party commented on the sunset clause.

Views of the Board

The Board notes CPA's comments concerning the non-recovery of depreciation when the actual amount of capital additions is less than that included in the test-year forecast. The Board considers, however, that this would tend to be offset to a degree in those years when actual capital additions exceed the forecast. The Board also notes that CPA failed to recognize the benefit to the tollpayers of reduced income tax associated with the CCA on the forecast additions.

During the hearing, it became apparent that a number of interested parties had difficulty locating and identifying various projects in Westcoast's filed information. It appeared that Westcoast listed its construction projects in random order in its application, thus making it difficult to determine the date of Board approval for each project. To aid all parties in this regard, the Board directs Westcoast to list the projects on pages 2.7 to 2.15 of the Rate Base section in chronological order by date of Board approval in future toll applications.

The Board considers it unnecessary at this time to amend the NPIS adjustment mechanism or the sunset clause aspects of the facility approval process. The Board considers that the manner in which the sunset clause is administered continues to be appropriate.

Decision

The Board approves the applied-for net plant in service adjustment factor of 0.712 percent.

The final approved NPIS adjustment is $6,164,000.

3.2 Grizzly Valley Tax Reassessment

In 1989, Revenue Canada reassessed Westcoast approximately $13 million in income taxes and interest penalties related to the $20 million settlement of the Grizzly Valley pipeline litigation. On the advice of its tax advisors, Westcoast appealed the reassessment. In order to prevent non-deductible interest charges, this amount plus an additional $2.5 million in respect of an earlier Grizzly Valley pipeline reassessment was paid to Revenue Canada, pending the outcome of its appeal.

Westcoast proposed to add the $15.5 million paid to Revenue Canada, together with $1.525 million in carrying charges, to rate base in January 1990. Westcoast stated that it does not propose to amortize this amount to the cost of service until the appeal process is concluded.

Westcoast indicated that it proposed to include the amounts in rate base for the following reasons:

(1) The tollpayers in 1986, 1987 and 1988 had the benefit of a significant reduction in cost of service as a result of the net settlement proceeds being treated as a non-taxable receipt, and the Board having directed Westcoast to credit to the cost of service over a three-year period the net settlement receipts, on the assumption that the settlement was not taxable. In addition the unamortized credit was included in the determination of the test-year rate base.

(2) The carrying costs for the income tax reassessment are properly a utility expense and must be borne by the tollpayers. The appropriate carrying cost is the rate of return on rate base since the payment has been financed by the total utility capital.

(3) If Westcoast deferred recovery of the tax reassessment and the carrying costs to the conclusion of the appeal process, and if Westcoast were unsuccessful, the amount which might then have to be recovered could exceed $25.0 million by 1994. In addition, Westcoast would have to recover in its cost of service the related income taxes. The recovery of such a large amount relative to the size of Westcoast's cost of service might well cause a significant distortion in tolls.

(4) The tollpayers in 1986, 1987 and 1988 enjoyed the benefit of the credits arising out of the settlement through lower tolls. The deferral of the recovery of both the income taxes paid and the carrying costs thereon to tollpayers in 1994 and beyond would give rise to serious concerns about intergenerational inequity.

(5) If the appeal is successful and Westcoast recovers interest from Revenue Canada on the payment, then that interest will be credited to the tollpayers at the time that it is recovered. Any intergenerational inequity which arises

as a result of current tollpayers bearing the carrying costs while future tollpayers share in the receipt of the interest paid by Revenue Canada will be significantly less than the inequity which would result if both the income tax payment and the carrying costs were deferred for recovery from future tollpayers.

In argument, Westcoast reiterated its position that the balance in the deferral account should be included in rate base and should receive a return based on the rate of return on rate base, rather than the short-term borrowing rate, because this is just a mirror image of the amortization of the item that was included in rate base in 1986, 1987 and 1988.

CPA argued that this account should be considered as a special non-recurring deferral account and should only be entitled to the short-term borrowing rate.

The Independent Petroleum Association of Canada ("IPAC") suggested that the appropriate carrying cost should be the interest rate charged by Revenue Canada on income tax assessments. Using this rate, the effect of the cost or benefit on Westcoast and its tollpayers would be neutral.

Views of the Board

The Board notes the views of the interested parties concerning the apparent non-recurring nature of this item and recognizes that it could well have been influenced by this argument in other circumstances (see section 4.7.2). However, the Board has been persuaded by Westcoast's arguments supporting the rate base treatment of this item, in particular the Company's argument that its proposed treatment is a mirror image of the credit to rate base in the years 1986 to 1988 relating to the projected tax benefit to the tollpayers arising from the settlement proceeds from the pipeline suppliers.

Decision

The Board approves the applied-for rate base treatment in respect of the Grizzly Valley Tax Reasssessment.

3.3 Pension Expense Income Tax Deferral

In its RH-2-87 Westcoast Reasons for Decision, the Board directed Westcoast to adopt the procedure set out in Section 3460 of the Handbook of the Canadian Institute of Chartered Accountants ("CICA") and to account for pension costs on an accrued liability basis. Adoption of this procedure and delay in proposed federal legislation resulted in Westcoast being unable to obtain tax deductions in respect of accrued contributions to its pension plan of approximately $4.2 million in 1989. This delay resulted in an overstatement of income tax deductions credited to the utility tollpayers in 1989 and, correspondingly, an understatement of income taxes payable by the utility.

In June 1989, Westcoast advised the Board that it had included in the income tax deferral account approximately $1.8 million which represented the income tax associated with the $4.2 million in accrued pension costs which did not have an offsetting tax deduction.

Westcoast proposed that the $1.8 million plus accrued carrying charges of $120,000 be transferred to rate base on 1 January 1990 until such time as Westcoast is able to obtain a tax deduction in respect of the accrued pension plan contributions.

Views of the Board

For the reasons set out in section 4.7.2, the Board is of the view that this deferral account is more appropriately treated as a non-recurring deferral account.

Decision

The Board denies Westcoast's proposed rate base treatment of the pension expense income tax deferral account balance (see also section 4.7.2).

3.4 Deferred Income Tax Adjustment

In November 1988, the Accounting Standards Committee of the CICA issued an Exposure Draft, entitled "Corporate Income Taxes", for public comment. The Exposure Draft contains a proposed accounting recommendation which provides for adjustment of the balance of deferred income taxes to reflect changes in corporate income tax rates.

As more fully explained in section 4.7.1, Westcoast proposed to restate its deferred tax balance in conformity with the provisions of the Exposure Draft.

Views of the Board

For the reasons set out in section 4.7.1, the Board is not persuaded that Westcoast's deferred tax balance should be adjusted at this time.

Decision

Westcoast's proposed adjustment to its deferred tax balance is disallowed (see also section 4.7.1).

3.5 Adjustment to Working Capital

Decision

Westcoast is directed to make the necessary adjustments to its working capital provision to give effect to the Board's decisions set out herein.

3.6 Depreciation

3.6.1 New Depreciation Rates

Westcoast determined its accumulated depreciation balance and depreciation expense using the rates approved in Order TG-4-86, except for the following rates:

(a) Transportation Equipment Under 5 Tons:

Westcoast proposed to reduce the depreciation rate from 23 percent to 18.8 percent as a result of reassessing the service life for this class of vehicle.

(b) Aircraft:

Westcoast proposed a depreciation rate of 4.5 percent on the new aircraft, a rate which is in accordance with industry practice.

(c) Aitken Creek Plant:

The rate of 2.5 percent proposed for this new facility is the same as the existing rate for the Fort Nelson Processing Plant.

Westcoast proposed that these rates be used until a system-wide depreciation study is completed.

Views of the Board

The Board considers Westcoast's proposal, that the suggested rates be used in the period pending the filing of the depreciation study, to be reasonable.

Decision

The Board approves the applied-for depreciation rates for the transportation equipment under 5 tons, the new aircraft, and the Aitken Creek Processing Plant.

3.6.2 Depreciation Study

Westcoast expresssed concern that its composite depreciation rate of 2.1 percent is too low, being the lowest rate of any major pipeline in Canada, despite the fact that approximately 50 percent of the Company's rate base is dedicated to raw gas transmission and processing facilities. The Company stated that it would be prepared to conduct a new depreciation study and file it with the Board.

Views of the Board

Given that the last depreciation study was filed with the Board in 1985, the Board believes that a review of the continued appropriateness of the existing depreciation rates should be undertaken by Westcoast.

Decision

The Board directs Westcoast to undertake a depreciation study and to file it with the Board by 1 March 1991.

Cost of Capital

In its final update, Westcoast applied for a rate of return on common equity of 14.25 percent for the 1990 test year, on a deemed common equity component of 35 percent. Details of the applied-for capital structure and requested rates of return are shown in Table 4-1 and discussed in sections 4.1 to 4.5 of this chapter.

4.1 Funded Debt

In its updated application, Westcoast applied for a cost rate of 11.14 percent on its forecast test-year funded debt balance of $510,648,000. The applied-for dollar amount and associated cost rate reflected the estimated utility portion of the late-1989 issue of $60,000,000 of Series K debentures at a coupon rate of 10.375 percent.

The only funded debt issue raised during the proceeding was that of the appropriate methodology to be used in determining the amount of funded debt to be included in the utility capital structure and the associated cost rate. As in past proceedings, Westcoast employed what it termed the "net proceeds" approach. Under this approach, the cost rate for funded debt is calculated by dividing the total financial charges, that is, the sum of annual interest expense and the annual amortization of issuance costs, by the original net proceeds of the debt outstanding. Westcoast viewed this approach

Table 4-1

Applied-For Deemed Average Capital Structure and Rates of Return for the 1990 Test Year

	Amount ($000)	Capital Structure (%)	Cost Rate (%)	Cost Component (%)
Debt - Funded	510,648	59.45	11.14	6.63
- Unfunded	13,498	1.57	10.75	.17
Total Debt Capital	524,146	61.02		6.80
Preferred Share Capital	34,200	3.98	8.09	.32
Common Equity	300,648	35.00	14.25	4.99
Total Capitalization	858,995[1]	100.00		12.11

1 Total does not add due to computer rounding.

to be the most appropriate given that it makes no assumptions as to the use of the funds recovered from the tollpayers over the life of the debt issue that relate to issuance costs, or the ability of the Company to earn a return on these monies received prior to the maturity of the debt issue. Accordingly, Westcoast considered this approach to be the most conservative from its perspective.

Westcoast indicated that it had considered other methods of determining the dollar amount of funded debt and its associated cost rate. In particular, cross-examination focussed on an alternative method described as the "modified net proceeds" method. Under this approach, the cost rate is determined by dividing the total financial charges by the sum of the original net proceeds plus those issuance costs which have been amortized and recovered in the cost of debt. Thus, over the life of a debt issue the divisor gradually increases until it reaches the value of the gross proceeds of the issue. The Company objected to this approach, stating that it implicitly assumes that issuance costs recovered over the life of the debt issue are invested in rate base; if such monies were invested in rate base, they would be unavailable to the Company at such time as the debt instrument became due.

It was acknowledged that the amount of financial charges recovered relating to funded debt was the same under both approaches. However, because the "modified net proceeds" approach results in a higher funded debt component of the capital structure[1], it results in a lower funded debt cost rate and a lower overall rate of return, as compared to the applied-for figures.

During cross-examination, a Company witness acknowledged that the debt issuance costs are recovered from the utility tollpayers over the life of the debt issue. However, he noted the difficulty in tracing the use of these monies as they are received. In his view, the amounts recovered from the tollpayers would simply form part of Westcoast's general corporate funds.

CPA's expert witness was of the view that, provided that the Company is kept whole, the "modified net proceeds" methodology is preferable to the Westcoast approach in that the tollpayers will receive the benefit of a lower overall rate of return. The witness viewed it as reasonable to assume that, in the context of an expanding rate base, the issuance costs recovered from the tollpayers were being invested in rate base. He agreed that, while one cannot trace funds, there exists an approved methodology for allocating debt issues between utility and non-utility operations. As such, he felt it was appropriate to convey a benefit to the utility tollpayer as the issuance costs were recovered by the Company.

Views of the Board

The Board recognizes that each of the methodologies for determining the amount and cost rate for funded debt has certain merits and drawbacks. However, the Board finds particular merit in the net proceeds methodology (referred to in the hearing as the "modified net proceeds" methodology) which recognizes that the Company recovers the utility portion of the issuance costs of a debt issue from the utility tollpayers over the life of the debt instrument. While acknowledging the difficulty inherent in tracing corporate funds, the Board does not consider this a serious obstacle.

Decision

The Board directs that the dollar amount of funded debt and the associated cost rate be determined using the "modified net proceeds" method as set out in Exhibit B-51.

Use of this net proceeds methodology results in the Board approving a dollar amount of funded debt of $513,745,000[2] and a cost rate of 11.07 percent for the test year.

4.2 Unfunded Debt

The amount of unfunded debt included in Westcoast's utility capital structure is determined by subtracting funded debt, preferred share capital and common equity from total capitalization.

In its application, Westcoast applied for a cost rate of 10.75 percent on its forecast unfunded debt balance for 1990, supported by a forecast long-term Government of Canada bond ("long-Canada") rate of 9.5 percent and a corporate issuing spread of 115 to 130 basis points. Westcoast found support for a long-Canada rate of 9.5 percent from the

1 Under this approach Westcoast estimated the 1990 funded debt component to be $514,174,000, and the funded debt cost rate and overall rate of return to be 11.07 percent and 12.06 percent, respectively.

2 This figure was provided by the Company in its final submission dated 12 January 1990.

average rates forecast by a number of economic forecasters, whose most recent estimates for 1990 ranged from 8.9 to 10.1 percent. Westcoast's expert witness was of the view that a corporate bond rate of 10.6 to 10.75 percent was a reasonable estimate for 1990, further noting that it was his opinion that interest rates were more likely to increase, rather than decline, during the test year.

As in past proceedings, CPA's expert witness stated that it was appropriate to cost the Company's estimated unfunded debt balance using a long-term corporate rate. However, he was of the view that the applied-for rate for 1990 was somewhat excessive. CPA's witness thought that investors, on balance, were expecting long-term interest rates to be somewhat lower in 1990 as compared to the current levels of 9.35 to 9.4 percent. CPA's witness concluded that an unfunded debt rate in the range of 10.375 to 10.5 percent was reasonable for 1990, with emphasis on the lower end of this range. The witness found support for this contention by reference to Westcoast's Series K debenture issue at a coupon rate of 10.375 percent (with warrants attached to the bonds allowing for the purchase in the near future of an additional $60,000,000 worth of bonds yielding 10.375 percent).

The expert witness representing the British Columbia Petroleum Corporation ("BCPC") also viewed Westcoast's requested rate as being too high, recommending a rate of 9.8 percent. This rate was comprised of a long-Canada forecast of 9.0 percent and a spread between corporate and long-Canada yields of 80 basis points. In support of the spread of 80 basis points, he provided data that indicated that the spread between Westcoast's debt and long-Canada rates had averaged some 80 basis points for the Company's last four debt issues prior to 1989. Westcoast's expert witness acknowledged that the method used by BCPC's witness was one way of estimating the appropriate corporate issuing spread. However, he stated that investment bankers determine the spread in a somewhat different manner (i.e. in relation to the long-Canada yield for debt of equivalent maturity as of the day the investment banker sells the debt). On this basis, the spread for Westcoast's Series K debentures issued in late 1989 was 119 basis points [1].

Views of the Board

The Board continues to believe that, as a matter of principle, unfunded debt balances should be costed using an estimated long-term corporate debt rate. The Board finds that the circumstances of this case do not warrant a departure from this principle.

In reaching its decision concerning the appropriate cost rate for unfunded debt during the test year, the Board gave considerable weight to the evidence presented that suggests that interest rates over the test year will be somewhat lower than the current level. The Board also gave recognition to the experienced spreads between long-Canada rates and Westcoast's corporate debt issues, as discussed by the Company's witnesses.

Decision

The Board finds an unfunded debt cost rate of 10.5 percent to be reasonable for the test year.

4.3 Preferred Share Capital

Westcoast applied for a cost rate of 8.09 percent on its preferred share balance of $34,200,000 for the 1990 test year. As in the case of the applied-for funded debt rate, the Company calculated the rate of 8.09 percent using the "net proceeds" approach (see section 4.1 for a more detailed discussion of the approaches considered during the hearing). Under Westcoast's approach, the cost of preferred shares is calculated by dividing the yearly dividend plus the yearly amortization of issuance expense by the original net proceeds of the preferred share issue.

Decision

Consistent with its decision in section 4.1, the Board directs that the dollar amount of preferred share capital and the associated cost rate be determined using the "modified net proceeds" method as set out in Exhibit B-51.

As a result of this decision, the Board approves a dollar amount of preferred shares of $34,566,000 and a cost rate of 8.01 percent for the 1990 test year.

4.4 Common Equity Ratio

Westcoast applied to maintain its deemed common equity ratio at the currently-approved level of

1 A Company witness indicated that the corporate issuing spread would have been about 130 to 135 basis points if Westcoast had issued 20-year debentures as opposed to 10-year debentures.

35 percent during the test year. The Company stated that it views a 35-percent equity ratio as the minimum level acceptable.

CPA's witness recommended a deemed common equity ratio of 30 percent for the test year, while BCPC's witness recommended an equity ratio of 34 percent.

As in past proceedings, testimony focussed on the three main factors normally considered by the Board in assessing the reasonableness of the deemed common equity component, namely:

(i) the business risks faced by Westcoast's utility operations;

(ii) the maintenance of an appropriate balance between the debt and equity elements of the deemed capitalization; and

(iii) the maintenance of an appropriate balance between the equity financing attributed to the utility through the deeming process and that portion of the actual equity financing which is left implicitly to underpin the Company's non-jurisdictional activities.

On the topic of business risk, Westcoast cited several areas where it believed that there had been an increase in risk since the Company's last toll proceeding. In particular, Westcoast referred to the following:

(i) the replacement of the sales agreement with Northwest Pipeline Corporation ("Northwest"), with several short-term transportation contracts;

(ii) the increased potential for competition from Alberta gas in Westcoast's markets;

(iii) the reduced level of support provided by the BCPC Agreement; and

(iv) the increased risk exposure associated with greater throughput volumes.

Westcoast saw this latter point as having increased its business risks, notwithstanding the change made by the Board in its RH-1-89 Westcoast Reasons for Decision to the Company's General Terms and Conditions as they relate to force majeure events occurring downstream of Westcoast's system. (The obligation to provide demand charge credits in such a case was removed by the Board in that Decision.)

CPA's witness was of the view that Westcoast's utility business risks had remained at approximately the same level as in 1987, and, if anything, had declined. He found support for his view in the recent behaviour of bond rating agencies and investors.

BCPC's witness was of the view that there had been no meaningful change in Westcoast's short-term business risks from those faced at the time of RH-2-87; however, he believed that the Company's longer-term business risks had decreased significantly. He cited the improving outlook for B.C. gas in both the export and domestic markets and pointed to the recent upgrade of Westcoast's bond ratings by the Canadian Bond Rating Service ("CBRS"). In argument, BCPC noted that one of the Company's expert witnesses was of the view that there had been only a slight increase in risk since RH-2-87 and that this assessment should serve as an upper limit. BCPC also argued that, while the contracts replacing the Northwest sales contract are short-term in nature, one should consider that the Northwest contract was effectively a short-term arrangement at the time of the RH-2-87 proceeding.

With respect to the appropriate balance between the debt and equity elements of the utility capitalization, Westcoast's witness noted that the Company's applied-for capital structure was almost identical to that approved in RH-2-87. Further, this witness stated that approval of an equity ratio of 30 percent, while not accentuating marketing difficulties in terms of the cost of transmission, would increase the difficulties of raising capital in the future at reasonable terms.

BCPC's witness viewed the likelihood of a bond-rating downgrade as being remote if his recommendations were accepted. In his opinion, a one percentage-point decrease in Westcoast's deemed common equity component should not impede Westcoast's ability to finance its rate base expansion at reasonable terms.

With regard to the issue of cross-subsidization, attention focussed on the potential impact of the proposed acquisition of the utility division of Inter-City Gas Corporation ("ICG") on Westcoast's

bond ratings and non-utility coverage ratios. Westcoast's expert witness was of the view that the proposed acquisition would not result in cross-subsidization because there had been no impairment of the Company's credit rating, the debt assumed by Westcoast's wholly-owned subsidiary in this transaction is without recourse to the parent, and to date, the marketplace has regarded the acquisition as a neutral event.

CPA's witness viewed Westcoast's projected non-utility coverage ratios as being inadequate in relation to those of other non-utilities rated BBB and above by the Dominion Bond Rating Service ("DBRS"). In his view, the relatively low bond ratings granted to Westcoast by the CBRS and DBRS clearly reflect the combination of low-risk utility operations with significantly higher-risk non-utility assets, to the detriment of the Company's tollpayers. After having assessed Westcoast's non-utility coverage ratios relative to a sample of Western Canadian oil and gas producers, BCPC's witness was persuaded that cross-subsidization exists. However, he noted in his evidence that the increase in Westcoast's investment opportunities as they relate to other utilities was beneficial to the Company in that they would serve to reduce the extent of cross-subsidization of its oil and gas investments.

Views of the Board

The Board notes the agreement among the witnesses as to the three criteria to be used in assessing a reasonable deemed common equity ratio. Further, the Board continues to be of the view that primary consideration should be given to the factors relating to utility business risk and a balanced utility capital structure. Only in the case of persuasive evidence concerning its likelihood should the potential for cross-subsidization be given considerable weight in assessing the reasonableness of the deemed common equity ratio.

With respect to business risk, the Board recognizes that the increase in the Company's projected throughput levels may have operating flexibility implications. Although increased throughput could reduce the ability to substitute different sources of supply in the case of unexpected outages, the Board expects that Westcoast will be able to manage its affairs so as to minimize the impact of any such outages and thereby minimize the associated risk. The Board also notes Westcoast's concern that its long-term sales arrangement with Northwest has been replaced by service contracts of a short-term nature. The Board, however, believes that in assessing risk, one should also look beyond the term of the contracts and assess the markets being served. The Board finds that Westcoast's overall market risks have not increased since RH-2-87 and, in fact, markets for natural gas appear more buoyant and secure than they have been in the recent past. Further, the Board finds merit in the position put forward during the hearing that Westcoast currently faces less uncertainty than it did at the time of RH-2-87. On balance, the Board believes that there has not been a significant change in business risks.

The Board was not persuaded by the evidence presented that the applied-for utility capital structure was unreasonable, in the context of maintaining an appropriate balance between its debt and equity elements.

On the basis of its review of the evidence related to the two main factors governing the determination of an appropriate deemed common equity ratio, the Board views 35 percent as providing adequate compensation for Westcoast's short-term and long-term business risks.

Concerning the issue of the possible cross-subsidization of Westcoast's non-utility activities, the Board notes the expected improvement in the Company's non-utility coverage ratios. Further, the Board gave weight to the fact that the Canadian bond rating agencies maintained the Company's credit ratings after having reviewed the implications of the proposed ICG acquisition. While there is no clear evidence that the investment in ICG has caused cross-subsidization, the potential implications of this acquisition on the Company's regulated operations may have to be examined in future proceedings.

Decision

The Board approves the applied-for deemed common equity ratio of 35 percent for the test year.

4.5 Rate of Return on Common Equity

Westcoast applied for a rate of return on common equity of 14.25 percent. The Company's expert witnesses relied on the comparable earnings, equity

risk premium and discounted cash flow ("DCF") tests in recommending this rate.

In their comparable earnings analysis, Westcoast's witnesses relied on data for a sample of low-risk industrials for the years 1983 to 1992, their view being that the current business cycle would most likely span that time period. In estimating an average return of 14.7 percent over the current business cycle, they forecast return levels ranging from 14.65 to 14.75 percent for the years 1989 to 1991, and 12.3 percent for 1992, a potential recession year. If a recession were experienced in the near term, the cycle-average returns would have been reduced to a level of 14.4 percent. However, the witnesses gave no weight to this result given their view that the recession would most likely not occur until 1992.

The witnesses adjusted their basic result downwards by 30 basis points to reflect the apparent lower risk of utilities relative to their selection of low-risk industrials. Such an adjustment had not been made in past proceedings. One of the witnesses stated that, in principle, he had always held the view that some adjustment for risk differences may be required, but that he previously had no evidence that indicated such an adjustment was warranted. While noting that his analysis was not conclusive evidence as to the magnitude of the adjustment, the witness noted that his adjustment was about the same as that made by BCPC's witness.

As in past proceedings, the Company's witnesses placed less weight on the results of the DCF test. In giving this test result only a 20 percent weighting, the witnesses cited several limitations inherent in the technique. The data for stable industrials indicated that the basic cost of equity was 12.45 percent, comprised of a dividend yield of 2.6 percent, a growth factor of 10.15 percent, and a downward adjustment of 30 basis points for risk. This basic rate was then adjusted to a level of 13.6 percent in order to provide for a market-to-book ratio of 1.15.

Westcoast's expert witnesses gave somewhat greater weight (30 percent) to the equity risk premium approach. In determining a fair rate of return on equity, the witnesses placed primary reliance on a study which determined the risk premium as the difference between the cost of equity for a sample of utilities and the cost of long-term Government of Canada bonds. The study indicated that for every percentage point decline in interest rates, the required risk premium for high-grade utilities increases by some 45 to 65 basis points. At a projected long-Canada rate of 9.5 percent, this study suggested a risk premium in the range of 3.8 to 4.5 percentage points. The witnesses also took into account that this risk premium range might be overstated by approximately 50 basis points because the study did not fully take into account the general downward trend in risk premiums prior to 1980. The witnesses' second risk premium study focussed on the expected risk premium of the market as a whole as measured relative to the Toronto Stock Exchange 300 Index. Results indicated a market risk premium of 4.5 percentage points. A downward adjustment to reflect the lower risk of utilities relative to an average-risk stock resulted in a risk premium of 3.375 percentage points. Based on these studies, the witnesses concluded that a risk premium of 3.75 percentage points was reasonable, in conjunction with a long-Canada rate of 9.5 percent. The resultant basic rate of 13.25 percent was then adjusted to 14.5 percent to reflect a market-to-book ratio of 1.15.

CPA recommended 12 to 12.25 percent as a fair rate of return on equity. Its witness employed the DCF and equity risk premium cost estimation techniques in his analysis.

The DCF test results indicated that the required rate of return for low-risk utilities was no more than 11.5 percent, after an adjustment for the lower risk of utilities relative to the witness' non-utility sample. Implicit in the final DCF cost of 11.5 percent was a growth component of 8.9 percent. In reaching his conclusion as to the appropriate growth component to be used in his DCF analysis, the witness continued to give primary weight to the growth rates calculated for the most recent five years for his sample companies. Given that the projected inflation rate is somewhat higher than the rate experienced in the last five years, he stated that his five-year growth estimates might be somewhat lower than the level anticipated by investors.

The main issue addressed in the context of the witness' DCF analysis focussed on the weighting technique used to estimate the growth component of the DCF formula. The Company's witnesses viewed the approach used by CPA's witness to determine the five-year growth rates as introducing a downward bias to the results of some 80 basis

points. CPA's witness acknowledged that there may be a bias in his results; however, he viewed his methodology as potentially producing historical growth rates in excess of those that could reasonably be expected in the future. He stated that if that were the case, his estimate of the investors' required rate of return would be overstated.

On the basis of his risk premium analysis, CPA's witness determined that the basic cost of equity capital for Westcoast was no more than 12 percent. This rate was comprised of a long-Canada rate of 9.5 percent and a risk premium of 2.5 percentage points. When it was noted that the witness had utilized the same risk premium in his RH-2-87 evidence, he responded that he saw little need to adjust his utility-related risk premium given that there had been only a 25 basis point decline in the long-Canada rates assumed in the two proceedings. The witness also found comfort in the fact that in his analysis the basic costs of equity capital, as measured by the DCF and risk premium approaches, were quite similar.

In reaching his final return recommendation, the witness essentially gave equal weight to his basic DCF and risk premium results. The resultant average basic cost of equity capital was augmented by 25 to 50 basis points, essentially to account for the recent behaviour and prospective volatility in interest rates. The witness stated that he augmented his basic results by a lower amount than in the RH-2-87 proceeding, given the expectation that long-term interest rates will decline from their current levels over the test year.

BCPC recommended a rate of return on equity of 12.5 to 12.8 percent. BCPC's witness supported this range through the application of the comparable earnings, equity risk premium and capital asset pricing model ("CAPM") techniques.

This witness' initial comparable earnings analysis focussed on the earned returns for a sample of low-risk industrials for the business cycle period 1981 to 1988. In selecting this time period, the witness expected inflation rates in the near future to closely mirror the historical inflation rate for this period. The witness also analysed the historical and prospective returns for his sample companies for the period 1983 to 1990, despite what he saw as the difficulties inherent in estimating future expected levels of return. The basic results of his two comparable earnings analyses produced a range of 12.9 to 13.1 percent. The witness adjusted these results downwards by 35 basis points to reflect Westcoast's lower risk relative to his sample companies and by a further 25 basis points to take into account his view that the market-to-book ratios of the sample companies were higher than required.

In concluding that his resultant comparable earnings range of 12.3 to 12.5 percent was reasonable, the witness made no adjustments to his basic results for the potential impact of inflation. In this regard, he noted that the projected inflation rate for the test year was not significantly different from that experienced during the 1981 to 1988 business cycle.

The witness' equity risk premium analysis was performed in relation to a sample of utility stocks, as well as his low-risk industrial sample. While the same 35 basis point risk adjustment was made in relation to the witness' low-risk industrial sample, he found no evidence to suggest that any such adjustment was required to his utility-based data. Giving equal weight to each of his risk premium studies resulted in a cost of equity capital of 12.3 to 13.1 percent. The witness suggested that no adjustment was required to this range to preserve the Company's financial integrity, given that the historical average returns for his sample companies were sufficient to allow them to achieve adequate market-to-book ratios. It was noted during the proceeding that the witness gave the results derived from this test 50 percent weight, which was somewhat greater weight than in RH-2-87. He viewed this as appropriate in that he had more confidence in his interest rate forecasts in this proceeding as compared to RH-2-87. He noted that, while he expected long-term rates to decline somewhat from their current levels, he anticipated the decline would not be significant.

The witness also performed a CAPM analysis as a check against the results of his two primary tests. He did not place great reliance on the final CAPM result of 12.3 to 13.1 percent, recognizing the problems inherent in using this approach. However, the witness was encouraged that the CAPM test confirmed the ranges of rates produced by his two primary cost estimation techniques.

Views of the Board

The Board finds it appropriate to give some weight to all of the estimation techniques presented by the expert witnesses during the proceeding.

With respect to the risk premium technique, the Board is cognizant of the difficulty inherent in assessing the risk of Westcoast's utility operations relative to those of an average stock and recognizes the problems inherent in relying solely on one measure to estimate the amount of the required risk adjustment. While the Board notes that the Company's witnesses examined a number of risk measures in attempting to determine the appropriate adjustment that should be made to the market risk premium, it was somewhat unclear as to how the witnesses' judgment was used in assessing the risk of Westcoast's utility operations relative to the market as a whole.

Witnesses for Westcoast and BCPC utilized the comparable earnings approach in their respective analyses. The Board concurs with these witnesses that some downward adjustment to their basic results is required because of the lower risk of Westcoast relative to a sample of low-risk industrials, and notes that the witnesses essentially agreed on the magnitude of the risk adjustment. While the Board agrees that such an adjustment is warranted, it recognizes the difficulty inherent in determining the appropriate amount of the required risk adjustment. The Board also notes that the witnesses had several companies in common in their low-risk industrials samples. It was not clear to the Board as to how much weight should be given to these results, given that there were several instances where the historical earned rates of return on equity for these companies were not the same as between the two sets of analyses. Further, the Board remains somewhat concerned about the possible distorting effects of past high and volatile levels of inflation on the comparable earnings results.

The Board notes the statements made by the Company's witnesses as to the likelihood of a recession commencing as early as 1990. These witnesses assessed the probability of a recession occurring by this time at less than 50 percent, yet gave it no weight in reaching their final rate of return on equity recommendation. To the extent that this possibility should have been taken into account, the Company witnesses' results would be somewhat overstated. In this regard, the Board recognizes the problems inherent in estimating prospective earnings levels for a sample of companies.

The DCF approach was not utilized by BCPC's witness, and given relatively little weight by the Company's witnesses given their views as to the limitations of the approach. While recognizing that such limitations do exist, the Board still believes that the results of the test should be given weight in assessing a fair rate of return on equity. As in past proceedings, argument focussed on the growth rate expectations of investors. In the Board's view, the growth expectation incorporated in the DCF analysis of Westcoast's witnesses may be somewhat overstated, given the witnesses' failure to attach any weight to the probability of a recession prior to 1992. However, the Board is also concerned that the growth estimates of CPA's witness may be downward-biased, as alleged by the Company's witnesses.

Based solely on a review of the results of the various cost estimation techniques, the Board concludes that, on balance, a downward adjustment to the currently-approved rate of return on equity is warranted. In addition, the Board gave weight to the evidence that long-term interest rates are expected to be somewhat lower than current levels during the test year. The Board also took into account its view that Westcoast is adequately compensated for its business risks in its approved common equity ratio.

Decision

The Board finds that a rate of return on common equity of 13.25 percent is fair and reasonable for the 1990 test year.

4.6 Rate of Return on Rate Base

Decision

The Board directed Westcoast to determine its rate of return on rate base based on the decisions set out in its December 1989 Decision (see Appendix II).

The approved capital structure and overall rate of return are shown in Table 4-2.

Table 4-2

Approved Deemed Average Capital Structure and Rates of Return for the 1990 Test Year

	Amount ($000)	Capital Structure (%)	Cost Rate (%)	Cost Component (%)
Debt - Funded	513,745	60.17	11.07	6.66
- Unfunded	6,635	.78	10.50	.08
Total Debt Capital	520,380	60.95		6.74
Preferred Share Capital	34,566	4.05	8.01	.32
Common Equity	298,817	35.00	13.25	4.64
Total Capitalization	853,764[1]	100.00		11.70

1 Total does not add due to computer rounding.

4.7 Income Taxes

Although the flow-through basis for determining the utility income tax requirement for the 1990 test year was not an issue at the hearing, several income tax-related issues were raised.

4.7.1 Deferred Income Tax Adjustment

In November 1988, the Accounting Standards Committee of the CICA issued for public comment an Exposure Draft entitled "Corporate Income Taxes". The Exposure Draft contains a proposed accounting recommendation which provides for adjustment of the balance of deferred income taxes to reflect changes in corporate income tax rates.

Westcoast proposed to implement the provisions of the Exposure Draft by restating the deferred income tax balance of $73,733,000, collected over the period 1979 to 1982 at a tax rate of 51.10 percent, to $61,457,000 to reflect the 1989-1990 tax rate of 42.59 percent, a reduction of $12,276,000[1].

Commencing with the 1990 test year, the Company also proposed to amortize the reduction in the deferred income tax account over a three-year period. Westcoast indicated that implementation of the provision of the Exposure Draft would reduce its test-year cost of service by $6,798,000.

None of the intervenors who addressed this issue supported Westcoast's proposal.

CPA expressed several concerns on this matter:

- The Exposure Draft had not yet been adopted by the CICA (i.e. it has not been released as a CICA Handbook recommendation) and, in any case, the Exposure Draft expressly provides that, even if it were implemented, regulated companies would not be required to adhere to its requirements.

- For consistency in Westcoast's application of the Exposure Draft, the deferred tax balance would have to be increased in the event of an increase in the tax rate in the future.

1 In its 8 November 1989 Update, Westcoast revised the tax rate to 41.757 percent to effectively eliminate the applicability of surtax to Westcoast as a result of the introduction of the Large Corporations Tax. Using this rate, the restated deferred tax balance would have been $60,250,000, requiring a downward adjustment of $13,483,000.

- The proposal's objective was (at least in part) to provide Westcoast with a marketing advantage by reducing the cost of service at this time. CPA stated that, in the past, the NEB had rejected the drawdown of deferred income taxes as a vehicle to lower tolls in the short term (for example when the Board denied TransCanada PipeLines Limited's ("TransCanada's") request to draw down its deferred income taxes in 1984, 1985 and 1986).

- Since the deferred tax balance is a deduction from rate base, a reduction in the balance would have the effect of increasing rate base and thus the return on it.

It was CPA's position that Westcoast should not be permitted to use the deferred tax balance as a means to reduce its current cost of service and increase its rate base - the balance should be preserved for dealing with cross-over in the future.

The Council of Forest Industries of British Columbia and Cominco Ltd. ("COFI/Cominco") also opposed Westcoast's request based on concerns relating to the future impact on the cost of service. COFI/Cominco observed that the rates would be forced down now but might be higher later. An increase in the tax rate would logically lead to the requirement to increase the deferred tax balance.

During cross-examination, a Company witness indicated that, if the Board were to approve the Company's proposal, its external auditors would support early adoption of the proposals contained in the CICA Exposure Draft for Westcoast's financial statements. While the witness agreed that the Financial Accounting Standards Board ("FASB") in the United States had delayed for one year implementation of a similar proposal after industry outcry against its complexity, he believed FASB's approach to deferred tax accounting was much more complex than the CICA's.

Westcoast maintained its position that it agreed with the accounting recommendations proposed in the CICA Exposure Draft. The recommendations provided a sound accounting basis for drawing down the deferred tax balance; consequently, the Company saw no reason to delay implementation. The Company also pointed out that the Board had rejected TransCanada's proposal to reduce its deferred tax balance because it was a departure from cost-based tolls and that the use of accumulated deferred income taxes in the manner suggested by TransCanada was viewed as contrary to sound accounting principles. The Company also suggested that three years would be an appropriate period over which to amortize the reduction in the deferred income tax balance, believing that amortization of the full amount in the test year would have an overly large impact.

Views of the Board

The Board notes that the basis for Westcoast's proposal is the anticipated approval of the proposed accounting recommendation contained in the CICA Exposure Draft on Corporate Income Taxes. The Board also notes that, in spite of the reduction in the test-year cost of service that would result from Westcoast's proposal, both CPA and COFI/Cominco opposed the drawdown of the deferred income taxes and espoused their concerns about the impact of implementing the CICA's Exposure Draft on Westcoast's future cost of service.

Having regard to the fact that the Exposure Draft had not been adopted by the CICA prior to the release of the Decision, and the comments of the intervenors, the Board is not persuaded that Westcoast's deferred income tax balance should be adjusted at this time.

Decision

The Board denies Westcoast's proposal to reflect in its cost of service at this time the proposed accounting recommendations for corporate income taxes set out in the CICA Exposure Draft dated November 1988. Consequently, the Board does not approve Westcoast's proposals to reduce its deferred income tax balance to reflect the decrease in the corporate tax rate and to amortize the amount so determined to the cost of service over a three-year period commencing in 1990 (see also section 3.4).

4.7.2 Pension Expense Income Tax Deferral

In its RH-2-87 Westcoast Reasons for Decision, the Board directed Westcoast to adopt the accrual basis for accounting for pension costs in accordance with Section 3460 of the CICA Handbook. Westcoast indicated that this procedure, with the delay in the implementation of certain relevant changes to the Federal Income Tax Act, resulted in

Westcoast being unable to obtain forecast tax deductions of about $4.2 million in 1989 in respect of accrued contributions to its pension plan. Westcoast stated that the income tax deduction credited to the utility in 1989 was overstated and the income taxes payable by the utility tollpayers was correspondingly understated.

In June 1989, Westcoast advised the Board that it had included in the income tax deferral account approximately $1.8 million, which represented the income tax associated with the $4.2 million in accrued pension costs which did not have an offsetting tax deduction.

CPA was the only party that took issue with Westcoast's proposal. CPA argued that the Company's course of action with respect to pension plan costs was designed to benefit the corporation rather than the tollpayers and the deferred amounts should be absorbed by the shareholders rather than recovered in the cost of service.

In reply, Westcoast maintained that it was unable to claim the tax deduction that was anticipated for reasons beyond Westcoast's control and that such events are intended to be covered by the income tax deferral account granted to the Company. Westcoast stated that the tollpayers had been given the benefit associated with the forecast deduction that did not materialize and, therefore, the Company did not find credible CPA's argument that the resulting costs should be absorbed by the shareholders.

Westcoast proposed that this amount plus accrued carrying charges of $120,000 be transferred to rate base on 1 January 1990 until such time as Westcoast was able to obtain a tax deduction in respect of the accrued pension plan contributions.

During cross-examination, Westcoast acknowledged that this deferral account could be characterized as non-recurring. Having regard to the Board's decision on deferral accounts in the RH-3-86 TransCanada Decision, Westcoast also acknowledged that the carrying charges for this deferral account could be determined using a rate other than the rate of return on rate base. However, in final argument, Westcoast took the position that this item should be included in rate base.

In its RH-3-86 TransCanada Reasons for Decision, the Board decided that TransCanada had two distinct types of deferral accounts: deferral accounts for recurring operating revenues and expenses, and deferral accounts for use in special non-recurring situations. With respect to the operating deferral accounts, because the debit and credit balances tend to offset each other over time, and the net balances should not be significant, the Board was of the view that the carrying charges on these accounts should be determined using a rate of return on rate base. However, the Board decided that carrying charges on deferral accounts established for non-recurring situations should be calculated using a rate that approximates the probable cost of financing the deferred balances.

Although not specifically addressing the question of an appropriate rate for determining carrying charges on deferral accounts, a Westcoast witness estimated that the Company's short-term borrowing rate would be 10.86 percent for 1990. The rate of 10.86 percent was based upon an estimated 1990 prime rate of 11.69 percent less an estimated 1.11 percent prime/commercial paper spread, plus a 0.28 percent estimate for commercial paper issuance costs.

BCPC's expert witness forecast a commercial paper rate for 1990 of 10.20 percent.

Views of the Board

The Board agrees with Westcoast that the event that gave rise to this deferral item was beyond the control of the Company. Accordingly, the Board is of the view that Westcoast should be permitted to record the applied-for amount in a deferral account. However, the Board does not agree with Westcoast that this item should be included in rate base and consequently accrue carrying charges based on the rate of return on rate base. The Board considers this item to be the result of a unique or special non-recurring situation and believes that a short-term borrowing rate of 10.75 percent should be used to determine the 1990 carrying charges for this account. The Board also is of the view that the 1990 carrying charges should be included in the 1990 cost of service.

Decision

The Board directs that the amount of the income tax associated with non-deductible pension costs be placed in a special deferral account. Further, the Board directs that the 1990 carrying charges in respect of the bal-

ance in this account be included in the 1990 cost of service using an estimated short-term borrowing rate of 10.75 percent (see also section 3.3).

4.7.3 Income Tax Rate Change Deferral Account Balance

In its Decision dated 11 December 1989, the Board directed Westcoast to credit $3,642,000 and associated carrying charges to the test-year cost of service rather than the applied-for income tax rate change deferral of $2,091,000, plus carrying charges.

On 22 December 1989, Westcoast requested that the Board review and amend sections 4.7.3 and 6.1 of its Decision in respect of this issue. Westcoast stated that it was unfortunate that the amount in the deferral account was erroneously characterized by it as reflecting a change in the tax rate in 1988 and 1989 rather than a deferral of excess revenue. Westcoast indicated that the actual excess revenue collected from the tollpayers was $2,091,000 and not the amount of $3,642,000 referred in the Board's decision.

The Board subsequently sought the views of interested parties before deciding on this matter.

Based on the facts that were brought to the Board's attention, the Board is satisfied that the appropriate amount to be credited to the 1990 cost of service is $2,091,000, plus carrying charges, as this amount reflects the true nature of the deferral, which was a deferral of excess revenue.

Consequently, the Board on 9 January 1990 amended sections 4.7.3 and 6.1 of its 11 December 1989 Decision and issued amending Order AO-1-TG-9-89 (see Appendix VII).

4.7.4 Flow-Through Tax Calculation

Decision

The Board directs Westcoast to adjust the 1990 test-year flow-through income tax provision to reflect the decisions set out in the Board's Decision dated 11 December 1989, as amended (see Appendix II).

The revised utility income tax allowance has been determined to be $23,573,000, an increase of $1,082,000 from the applied-for amount of $22,491,000 (see Table 4-3).

Table 4-3

Approved Utility Income Tax Allowance for the 1990 Test Year
$000

Return Related to Equity	41,039
Add:	
Depreciation and Amortization	30,473
Amortization of Issue Costs	834
Foreign Exchange Loss on Debt Redemptions	674
Pension Accrual	1,600
Excess Pension and Savings Plan	50
Large Corporations Tax	2,280
Deduct:	
AFUDC - Interest Portion	(972)
Financing Expenses	(344)
Capital Cost Allowance	(40,646)
Overhead During Construction	(4,070)
Cumulative Eligible Capital	(68)
Book Gains on Debt Redemptions	(162)
Taxable Income	**30,688**
Taxes at $\frac{0.41757}{1 - 0.41757} \times 30{,}688$	22,001
Less: Alberta Facilities	(73)
Add: Large Corporations Tax	1,645
Utility Income Tax Allowance	**23,573**

Chapter 5

Operating Costs

5.1 Salaries, Wages and Employee Benefits

5.1.1 Staff Complement

Westcoast projected a net utility operating and maintenance ("O&M") requirement of 803 permanent and temporary person-years for 1990. This represented an increase of 75 over the 1988 approved complement of 728 person-years. Westcoast stated that the additional person-years were primarily attributable to the takeover of the McMahon Plant operations from Petro-Canada Inc. and increased workloads resulting from higher natural gas throughputs and expanded services provided to shippers on the Westcoast system.

CPA, the only intervenor in final argument to comment on Westcoast's 1990 staff complement, did not take issue with the number of employees required to perform the regulated utility operations of Westcoast.

Decision

The Board accepts Westcoast's projected net utility staff complement for the 1990 test year.

5.1.2 Annual Rate of Increase

Westcoast's estimate of test-year salaries and wages was based on an assumed 5.5 percent increase to cover negotiated settlements with wage earners and pay for performance for salaried staff. This increase was based on the assessment that the Consumer Price Index ("CPI") would remain near 5.4 percent and that salary and wage increases in the industry would range from 5.0 to 6.0 percent for 1990.

Views of the Board

The Board notes that recent forecasts project that the average annual CPI for 1990 will be somewhat lower than 5.4 percent. Consequently, the Board is of the opinion that a five percent average increase in salaries and wages is reasonable for the test year.

Decision

The Board directs Westcoast to use a 5.0 percent average increase rather than the applied-for increase of 5.5 percent in calculating its salaries, wages and benefits expense for the 1990 test year.

As a result of the Board's decision to reduce the test-year escalation factor from 5.5 to 5.0 percent, the applied-for test-year allowance for salaries, wages and employee benefits to be recovered in tolls has been reduced by $181,000.

5.1.3 Allocation to Non-Utility

From the time it became actively regulated in 1979, Westcoast has allocated costs to non-utility operations and utility capital projects on either a negotiated fixed-fee basis or on the basis of actual hours worked as recorded on employees' time sheets. The negotiated fee is charged for regular services, such as payroll, that Westcoast provides to its subsidiary companies. All additional work done is allocated on the basis of the actual direct cost plus an overhead charge of 65 percent. The overhead charge is comprised of direct and indirect employee benefits (15 percent each for a total of 30 percent), administrative support (30 percent) and corporate overhead (5 percent). Any amounts which are not allocated automatically become a charge against the utility.

The method of allocation was examined during the first Westcoast hearing in 1979 and has been reviewed in various hearings since then, the last occasion being the 1987 hearing.

According to Westcoast, the allocation of costs to non-utility operations provides a direct benefit to

the utility cost of service, and consequently to the tollpayers, by causing tolls to be lower than would otherwise be the case.

Westcoast stated its belief that the objective of any allocation process is to fairly allocate costs between various corporate cost centres consistent with proper cost accounting procedures. In Westcoast's opinion its allocation procedures and the resultant costs which are allocated not only meet this objective but, because of certain checks which are built into the system, assure a reasonable degree of accuracy. In the current application Westcoast has continued to use this method of allocation.

In the preparation of budgets, time is allocated on the basis of known and forecast workloads and on past experience. At the conclusion of the budget year actual time is compared with the forecast, and in addition the entire process is reviewed periodically by the Company's internal auditor. With respect to the 1990 test-year allocation to the Vancouver Island Pipeline Project, Westcoast stated that the forecast amount was basically to maintain the momentum of the Project, and did not include any amount associated with its construction. Consequently, Westcoast proposed the introduction of a deferral account to record any variance between the actual and estimated amount.

Interested parties questioned Westcoast's allocation procedures, believing that the amounts allocated to non-utility operations should, on a year-over-year basis, be increasing because the utility pipeline operation is becoming a proportionately smaller segment of the overall corporate enterprise.

CPA questioned whether allocation procedures which were developed in the 1970's were still applicable, considering Westcoast's increasingly heavy involvement in non-regulated activities. In CPA's view, top-level executives of the Company will now have to devote a large portion of their time analyzing and reviewing corporate matters such as the purchase of ICG. This should result in greater amounts of executive time being allocated to non-utility. In addition, Westcoast executives were involved in the Vancouver Island Pipeline regulatory hearings before the British Columbia Utilities Commission, and may have to devote significant time in the test year to regulatory hearings in Manitoba and Ontario relating to the ICG takeover.

IPAC stated that Vancouver department costs and unallocated administration costs had not been allocated in a fair and reasonable manner. In its opinion a more thorough and subjective examination of each account is required.

Views of the Board

The Board believes that cost allocation procedures should be designed to allocate costs between utility and non-utility activities fairly and consistently, with as little cross-subsidization between regulated and non-regulated activities as possible.

It is the Board's opinion that any allocation procedure requires a degree of judgment. The Board believes that Westcoast's allocation of costs between utility and non-utility in the 1990 test year meets the tests of fairness, reasonableness and absence of significant cross-subsidization. In reaching this conclusion, the Board notes that Westcoast has allocated a significant portion of its executive department to non-utility for the test year, 43 percent compared with 33 percent in 1988. The Board also notes that the head office executive and manager groups combined have been allocated 18 percent to non-utility for the test year compared to 12 percent in 1988[1].

Decision

The Board accepts Westcoast's method of allocating costs to non-utility as being reasonable for the test year. However, the Board directs Westcoast to record in a separate deferral account any variance between the actual amount and the estimate included in the application in respect of the Vancouver Island Pipeline Project (see also section 6.4).

5.2 Retainer Fee

In its RH-6-85 Westcoast Reasons for Decision, the Board established a retainer fee of $120,000 to reflect the value of having a pool of talent readily available to assist Westcoast's non-jurisdictional affiliates.

Since the last toll proceeding in 1987, Westcoast has significantly expanded its activities in areas outside of the Board's jurisdiction. These activities include

1 Source: Exhibit B-16, Westcoast's response to BCPC Information Request 39.

investments in such entities as Pacific Coast Energy Corporation ("PCEC") and more recently ICG. Indeed, the Company has changed its corporate name to emphasize these new corporate ventures.

In argument, several intervenors raised concerns regarding the allocation of unutilized personnel time between utility and non-utility activities. Specifically, since the non-utility operations bear only costs for personnel time actually used, all idle time costs are automatically absorbed by the regulated utility. COFI/Cominco submitted that the retainer fee of $120,000 was not adequate to compensate for this problem.

Views of the Board

The Board recognizes that the determination of the amount of this fee is necessarily subjective and judgmental. Having regard to the greatly increased sphere of Westcoast's non-jurisdictional activities, and allowing for some inflation since this fee was last determined, the Board is of the view that an increase in the retainer fee is warranted.

Decision

The Board directs Westcoast to increase the retainer fee to $200,000 for the 1990 test year.

5.3 Profit Contribution on Services Provided to Non-Utility Activities

Westcoast and Alberta Energy Company Ltd. each have a 50 percent equity interest in PCEC, the company that will construct and operate a pipeline to transport gas to Vancouver Island.

On 1 October 1988, Westcoast and PCEC entered into an agreement whereby Westcoast would supply engineering, procurement and construction services during the construction phase of the pipeline.

Pursuant to the terms of the agreement, PCEC will pay Westcoast for providing these services. In addition to the direct costs, Westcoast will add a surcharge of 85 percent to cover salary burden, overhead and a profit contribution on services provided to PCEC.

The 85 percent surcharge is 20 percentage points higher than the standard overhead charge Westcoast applies when allocating costs to other non-utility operations (refer to section 5.1.3), and represents the contribution agreed to by PCEC in recognition of Westcoast's management of the construction of the pipeline.

During cross-examination, Westcoast agreed that the expertise which enabled the Company to provide such services at a profit was a direct result of its resources and experience in operating the pipeline under the Board's jurisdiction. For this reason, both CPA and COFI/Cominco argued that the profit in question should be included in the pipeline's revenue requirement calculation in its entirety and thereby benefit the tollpayers through lower tolls.

In argument, Westcoast expressed the view that the risks associated with the performance of this contract should not be borne by the utility tollpayers, and therefore the extra compensation above basic costs for assuming such risks should flow through to the shareholders rather than to the tollpayers. If the tollpayers want the 20 percent profit contribution, then they should be willing to assume the risks associated with the project. Westcoast noted that the intervenors did not indicate a willingness to assume these risks.

Views of the Board

Whether regulated companies, such as Westcoast, ought to be allowed to retain all or a part of any profit contribution in respect of non-jurisdictional activities involving pipeline personnel as the companies continue to expand into new areas or ventures not regulated by the Board is a difficult judgmental matter.

The conflicting arguments put forth by Westcoast and intervenors indicate the controversial nature of this matter. In support of its position, Westcoast alluded to the potential risks faced by Westcoast in the performance of the PCEC contract. The intervenors, on the other hand, reasoned that the tollpayers should be entitled to the profit by virtue of the fact that the expertise that allowed Westcoast to provide the service was the result of constructing, and operating, the existing regulated pipeline system.

The Board also is concerned that the provision of these services to PCEC under contract might have a negative impact on the pipeline operations should the engineering services be required by PCEC during a peak rather than slack construction period of Westcoast.

As this issue was raised only in the late stages of the proceeding, the Board considers that there is insufficient evidence on the record for it to consider altering Westcoast's suggested retention of the 20 percent profit contribution arising out of this project for its shareholders. The Board notes that the utility operation does receive the credit for the basic costs of providing the service.

Decision

The Board has decided not to alter the treatment of the 20 percent profit contribution on services provided in respect of Westcoast's Engineering, Procurement and Construction Services Agreement for the Vancouver Island Pipeline Project.

5.4 Liability for Vacation Pay

In 1980 Westcoast revised its vacation policy to recognize that employees are entitled to take vacations in the year in which they are earned. Previously, the entitlement had been recognized on the basis that vacations could only be taken in the year after they are earned. With the implementation of the new policy, the Company incurred a liability respecting vacations earned by employees on staff prior to 1 May 1980. The amount of this vacation entitlement is being paid to each employee upon termination or retirement. Currently the amount of the liability to be charged the cost of service is forecast on a cash basis rather than an accrual basis.

Westcoast believed that the unrecovered liability should now be recognized on an annual basis in a manner similar to the recording of pension costs. The amount of the liability is estimated to be $1.7 million and represents the future vacation pay liability based on the salaries of those employees who were hired prior to 1 May 1980 and who were expected to be on staff at the end of 1989. Westcoast proposed amortizing the liability to the cost of service at an annual cost of $82,000 over a twenty-one year period, which is the expected remaining service life of these employees. The amount of the liability will be reviewed periodically.

CPA and COFI/Cominco took the position that, if the Board were to decide that this is a proper charge to be recovered in the tolls, it should continue to be recognized on a cash basis. Under the cash basis, the 1990 cost of service would be charged with an amount of $93,000 compared with $82,000 under the accrual method.

Views of the Board

The Board believes that Westcoast's liability for the payment of the accrued vacation pay is a cost that is properly chargeable to the cost of service. This being the case, it is the Board's opinion that the preferred method of collecting the estimated $1.7 million accrued liability in the cost of service is to recover it in equal annual amounts of $82,000 over the twenty-one year service life of the employees who were on staff when the policy was revised.

Decision

The Board approves Westcoast's proposal to reflect in the cost of service vacation pay liability determined on an accrual rather than a cash basis.

5.5 Vancal Lease

Westcoast's head office is located in a building owned by Vancal Properties Ltd. ("Vancal"), a wholly-owned subsidiary of Westcoast Construction of the building was completed in 1969 and it was leased in its entirety to Westcoast pursuant to a head lease with a primary term of 25 years. The terms of the lease required Westcoast to pay rent equal to the annual owning and operating costs of the building. Westcoast, in turn, subleased space to two tenants at commercial rates negotiated at arm's length and recovered its remaining net rental cost through the cost of service.

In 1988 it was determined that a significant amount would have to be expended to upgrade the building to meet current health and safety standards. The projected cost was $4.3 million and included such items as asbestos removal, installation of sprinkler and fire protection and heating, ventilating and air conditioning.

In ordinary circumstances, where the lessor and lessee deal at arm's length and the rent is determined by conditions prevailing in the marketplace, the landlord, in this case Vancal, would be responsible for upgrading the building or suffer a potential revenue loss resulting from the tenants seeking alternative upgraded accommodation within the same locality. However, under the terms of the old lease Westcoast was obligated to assume responsibility for both normal leasehold improvements and building upgrades and any similar expenditures which might be required in the future.

After considering the age of the building and options available to it, Westcoast decided that the appropriate course of action would be to restructure the lease arrangement with Vancal to put it on a more usual or arm's length basis. Consequently, the lease was amended, effective 1 January 1989, to reflect an arm's length relationship whereby Vancal will be responsible for the $4.3 million cost of the building upgrade and the rent paid by Westcoast will be based on market rates in Vancouver. As a result, at the time of the hearing only $1.382 million of leasehold improvements were on the Company's books.

Under the terms of the amended lease, Westcoast will lease the entire building until 31 December 1993 for an annual basic rate of $16.00 per square foot plus the payment of all operating costs and taxes. The basic rate will then be renegotiated for three additional years on the basis of the cost of renting equivalent accommodation at that time. Westcoast relied on information provided by two independent real estate professionals in Vancouver to determine the basic rate of $16.00 per square foot.

Evidence adduced during the hearing revealed that Westcoast did not think the building would suit the utility's requirements beyond 1994, and that the Company was actively negotiating the sale of the building and land.

Certain intervenors were opposed to including the amended rent cost in the cost of service, taking the position that the test-year rent should be determined on the basis of the old lease. COFI/Cominco stated that, in view of the relationship between Westcoast and Vancal, the lease amendment was not negotiated at arm's length and, COFI/Cominco, along with CPA, questioned the weight that should be given to the letters from the real estate professionals because there had not been an opportunity to cross-examine the authors.

With respect to the remaining leasehold improvement items under the new lease, CPA and IPAC questioned whether some or all of these items could be characterized as building upgrades and therefore removed from rate base. In their view, many of these items appeared to be capital improvements to the building which would normally be the responsibility of the owner and were not leasehold improvements in the ordinary meaning of the term. They were, however, of the view that if the Board should approve the inclusion in rate base of the $4.3 million, this amount should be amortized over a period of 20 years, not over the length of time the utility remains in the building. IPAC was of the opinion that, if the Board approves the amended lease and the building is subsequently sold, some of the resulting capital gain should accrue to the tollpayers.

Views of the Board

The Board notes that the Westcoast building has never been included in the utility rate base where it would have earned a return and, as noted by CPA, the tollpayers have had the benefit of a very favorable lease arrangement throughout the period of the original lease. The Board also notes that Westcoast will not commit itself to remaining in the building beyond 1994 and that, during that five-year period, the rental cost charged to the cost of service will be lower under the amended lease than under the original lease. Therefore, it appears to the Board that in these circumstances, and with the impending sale of the land and building, the revised lease arrangement is a reasonably fair arrangement for the tollpayers. Furthermore, the Board has not been persuaded that any amount of the remaining leasehold improvements should be removed from rate base.

Decision

The Board approves Westcoast's proposal to reflect in the cost of service a rental charge for the Vancouver head office based on the new lease agreement.

5.6 Marketing and Corporate Development Charges to Utility

On 1 January 1989, Westcoast removed the Gas Marketing Division from its utility operations, and indicated that it planned to remove the Corporate Development Division effective 1 January 1990. Previously both divisions had been part of the Company's utility operations and had charged time spent working on these non-utility operations on the basis of employee time sheets. Under that system any marketing or corporate development division costs not charged to non-utility operations remained with the utility and were recovered in the Company's tolls. Commencing with the 1990 test year the utility will only be charged for the services it receives from these divisions. These amounts were forecast to be as follows:

Division	Total Budget ($000)	Allocation to Utility ($000)
Marketing	1,066	304
Corporate Development	1,368	83

The Gas Marketing Division, which will employ seven persons in 1990, provides a variety of services to the utility including the administration of pre-1989 domestic sales agreements, promoting B.C. natural gas and the pipeline system, and assistance regarding U.S. regulatory matters. The cost allocated to the utility cost of service for the test year represents two-sevenths of the Marketing Division's costs or the equivalent of two person-years. The Corporate Development Division, which is comprised of 14 persons, is responsible for producing the Company's annual report, internal newsletter, handling investor relations and undertaking financial projections relating to potential acquisitions or investments.

IPAC expressed the view that, while the Gas Marketing Division should not be part of the utility, reclassifying it as non-utility is not the way to proceed. IPAC stated that the marketing function should be set up as a separate corporate entity. In IPAC's opinion, too many of the costs of buying and selling gas are being charged to the pipeline and it urged the Board to disallow all such costs.

Views of the Board

The Board is of the view that reclassifying the Gas Marketing and Corporate Development Divisions as non-utility will enable the tollpayers to more easily assess the reasonableness of the costs of these divisions charged to the test-year cost of service. The Board is of the view that the methods used by Westcoast to allocate division costs to utility operations for the 1990 test year are reasonable.

Decision

The Board approves the methods used by Westcoast to allocate portions of its non-utility Gas Marketing and Corporate Development expenses to utility operations.

5.7 Canadian Gas Association Costs

Westcoast included $110,000 in the cost of service for contributions to the Canadian Gas Association's ("CGA's") Advertising ($50,000) and Natural Gas Vehicle Research ($60,000) programs. The Company believed that programs of this type benefit all segments of the gas industry and are proper expenditures for inclusion in the cost of service. Westcoast noted that British Columbia is in the forefront in terms of usage of natural gas vehicles. The Company believed that research and development for natural gas vehicles could benefit the economics of the pipeline system because of the nature of the load, the load factor being relatively constant and indeed higher in the summer.

BC Gas supported Westcoast in its position, while IPAC and COFI/Cominco were opposed to having expenditures of this type allowed in the cost of service. IPAC questioned whether advertising relates to the promotion and, consequently, marketing of natural gas and is therefore an expense which should more properly be charged to the marketing department. In IPAC's opinion, the Board's RH-1-88 Phase II TransCanada Decision, which disallowed costs respecting contributions to CGA advertising and research and development programs, was the correct one, and allowing Westcoast to recover these amounts in its tolls would amount to an involuntary contribution by the tollpayers.

Views of the Board

The Board is not persuaded that all of the benefits flowing from the CGA's advertising and research programs relate to the promotion of the pipeline system. In the Board's opinion these benefits appear to relate more to the marketing of natural gas than to the promotion of the types of services provided by Westcoast. Therefore, in the Board's opinion, these programs should be charged to the Marketing Division with the pipeline bearing its share through the normal allocation process.

Decision

The Board denies Westcoast's proposal to include in its utility cost of service the full amounts of Westcoast's proposed contributions of $60,000 to the CGA Advertising program and of $50,000 to the Natural Gas Vehicle Research program. The Board directs that these amounts be included in Westcoast's Gas Marketing Division expenses for the 1990 test year. Consequently two-sevenths of these amounts, or $31,000, will be allocated to utility operations for the test

year.

At the time of filing its final Rate Base and Cost of Service schedules with the Board, Westcoast stated that if it actually contributed an amount that was lower than the amount proposed during the RH-2-89 proceeding, the Company would apply to the Board for a deferral account to record the cost difference attributable to utility operations. The Board finds the Westcoast proposal acceptable.

5.8 NEB Cost Recovery

Westcoast included an amount of $1,794,000 in the cost of service in response to the Board's proposal to recover a proportionate share of the cost of its operations from the companies it regulates. It is anticipated that the NEB cost recovery program will become effective early in 1990. This program is being implemented to satisfy the requirements of the Budget Paper tabled in the House of Commons on 27 April 1989.

Because the actual cost recovery levy was unknown, the Company requested a deferral account to record the difference between the actual amount and the amount included in its application.

Decision

The Board approves the inclusion of a provision of $1,794,000 in Westcoast's cost of service in respect of the NEB Cost Recovery Program. The Board also approves Westcoast's request for a deferral account to record any differences between the provision and the actual fee levied (see also section 6.4).

5.9 Other Miscellaneous Matters

5.9.1 Calgary and Ottawa Offices

Westcoast maintains office space in Calgary and Ottawa, with the Ottawa office being shared with other pipeline companies. The Gas Supply Department, which is staffed with geologists and reservoir engineers, is located in Calgary. This department monitors gas reserves in British Columbia and Alberta and undertakes studies based on market forecasts to determine future facilities requirements. The Gas Supply Department is also responsible for updating reserve reports in accordance with the First Mortgage Bond Deed of Trust. The Ottawa office was stated to be required whenever Westcoast personnel are involved in regulatory proceedings or other business matters that are before the Board.

The necessity of maintaining offices in these locations was raised by IPAC during cross-examination of Westcoast's cost of service witnesses, and in final argument, IPAC suggested that the Board might wish to direct Westcoast to file information supporting its requirement to maintain a Calgary office in the next toll hearing.

Views of the Board

After considering the evidence of Company witnesses respecting the necessity and cost of maintaining office space in Calgary and Ottawa, the Board believes that these offices are of benefit to the users of the pipeline system.

Decision

The Board finds Westcoast's rationale supporting the need for these two offices to be reasonable.

5.9.2 Industry and Association Dues

Westcoast is a member of various industry associations, such as the Canadian Gas Association and the Canadian Petroleum Association, and has included an amount of $300,000 in the cost of service for 1990 association dues. Company witnesses stated that the utility benefits from these memberships by keeping abreast of developments within the industry through their attendance at various meetings and by maintaining contacts with other industry members.

IPAC took the position that it was not opposed to Westcoast's membership in these industry associations; however, it was opposed to the pipeline's tollpayers paying for them through the cost of service. In IPAC's view, some of these industry associations might not be pipeline related; therefore, the Board should establish an appropriate amount that should be recovered in the cost of service.

Views of the Board

The Board is of the opinion that the regulated pipeline operations of Westcoast benefit from the Company's membership in industry associations

by allowing its employees to keep abreast of events affecting the pipeline industry. However, the Board is concerned with the apparent rapid increase in the number of these memberships and will require Westcoast, in any future toll application, to justify its membership in any new association before the dues will be allowed to be recovered in the cost of service.

Decision

The Board approves the applied-for amount for industry and association dues.

5.9.3 Surveillance Reports

In argument, IPAC was of the view that the Board should direct Westcoast to provide its quarterly surveillance reports directly to IPAC rather than IPAC having to obtain them from the Board.

Views of the Board

With regard to quarterly surveillance reports, the Board has recently taken steps to improve both access to and the information provided by Westcoast and other gas pipelines in such reports.

In recognition of the increasingly complex corporate organization of Westcoast, the Board directs Westcoast to file with the Board, as part of its quarterly surveillance report, a list of all non-arm's length transactions of the pipeline over $50,000 each and their bases of valuation. This reporting requirement commences with the first quarterly report of 1990. In this regard, Board staff will meet with the Company to determine the format of these reports. Access to such reports will continue to be provided by the Board to interested parties.

5.9.4 Filing of Toll Applications

Westcoast indicated that its annual corporate budgeting process for the succeeding calendar year is normally completed in October of each year.

Views of the Board

The Board is of the view that, while the current budget process may have been appropriate under a variable-cost-of-service method of regulation, it is out of step with a reasonable timetable for processing an application under a fixed-forward test-year method of regulation. This existing budget process makes it very difficult for new tolls to be approved before the commencement of a test year. Both the Board and interested parties would prefer to have final tolls in place before the beginning of a test year.

To permit the orderly hearing of an application, and to permit new tolls to be in place for the beginning of a test year, the Board is of the view that Westcoast should take the necessary steps to modify its budgeting process in respect of its pipeline operations so as to enable it to file an application by 1 July of each year.

Decision

The Board directs Westcoast to take the necessary steps to enable it to file future toll applications not later than six months prior to the commencement of the next test year.

Chapter 6

Deferral Accounts

6.1 Income Tax Rate Change Deferral

Decision

In its Decision dated 11 December 1989, the Board directed Westcoast to adjust the deferral account balance to reflect a deferral of $3,642,000 (see also section 4.7.3).

Subsequent to that decision, based on facts brought to the Board's attention by Westcoast the Board amended its decision and directed Westcoast to reflect a deferral of $2,091,000 (see also section 4.7.3).

6.2 Dispositions of Existing Deferral Accounts

Westcoast proposed that the existing deferral account balances be disposed of by either debiting or crediting the 1990 cost of service of each function or toll zone.

With the exception of IPAC's proposal which would allocate the deferral account balances to those shippers on the system on 31 October 1989 by a refund or extra charge to their bills, and the proposal of BC Gas Inc. ("BC Gas"), which would subdivide the operating demand ("OD") deferral account into domestic and export components, Westcoast noted that there appeared to be general agreement with Westcoast's proposed disposition of the deferral account balances.

IPAC proposed that the deferral account balances should, in general, be distributed over the customers "causing" them. In IPAC's view this would not constitute retroactive rate-making. BC Gas asserted that since 88 percent of the OD deferral account balance was caused by the export market, it was inequitable that the domestic core customers should bear a large part of those costs, and that the export market should bear the responsibility for them. COFI/Cominco supported the BC Gas proposal, stating that the Westcoast system was not a unified system at the time this deferral account originated.

Westcoast opposed BC Gas's proposal because the proposal ran against the principle enunciated by the Board in its RH-1-89 Westcoast Reasons for Decision, namely, that Westcoast's system was an integrated system designed to serve both domestic and export markets.

Views of the Board

While the Board agrees with IPAC that the Board does have the authority to order a refund in the appropriate case, it does not believe that it should do so in respect of the deferral accounts in question. These deferral accounts are for the most part not unique deferral accounts specific to a particular test year, or requiring a unique disposition. On balance, the Board believes that debits or credits to subsequent test years is the more appropriate method of disposing of the balances in the normal deferral accounts.

The Board does not agree with BC Gas's proposed disposition of the OD deferral account. As previously stated by the Board, Westcoast operates an integrated system designed to serve both domestic and export markets and the Board in its RH-2-87 Westcoast Reasons for Decision saw no reason to exclude the export market from the application of firm OD displacement relief.

Decision

The Board approves Westcoast's proposed dispositions of the balances in the revenue and expense deferral accounts.

6.3 Existing Accounts

6.3.1 Accounts to be Reinstated

Pursuant to Order TG-4-86, the Board approved various cost of service deferral accounts that

Westcoast had requested in its 1986 toll application and allowed carrying charges at the approved rate of return on rate base. The Company requested the continuation of these deferral accounts and the OD Revenue deferral account, with carrying charges, in 1989 and 1990.

Intervenors were not opposed to Westcoast's request.

Decision

The Board approves the reinstatement of the deferral accounts requested by Westcoast.

6.3.2 Accounts to be Discontinued

The Board notes that as a result of its RH-1-89 Westcoast Reasons for Decision, deferral accounts in respect of the following items are no longer required.

- Laprise Off-Load Project
- Authorized Overrun Revenues
- Interruptible Sales and Service Revenues
- Interruptible Transportation Storage Service Revenue - Injection
- Firm Transportation Storage Service Revenue

Decision

The Board directs that Westcoast discontinue these deferral accounts.

6.4 New Accounts

(a) Revenue

(i) Contract Demand Volumes

Westcoast requested a deferral account for the variances between the forecast and actual contract demand ("CD") volumes for the period 1 November 1989 to 31 December 1990. IPAC supported a deferral account for increases in firm demand volumes but did not support such an account if the actual firm demand volumes were to be less than forecast.

(ii) 1989 Revenue Deferral Account Variances

Westcoast asked for this deferral account to provide for variances between estimated and actual 31 December 1989 revenue deferral account balances, and proposed that the balance be recovered in a future toll proceeding.

(b) Cost of Service

(i) NEB Cost Recovery

Westcoast requested this deferral account to provide for the variance between the estimated and actual charge to be made by the NEB under the Board's proposal to implement cost recovery. This program is anticipated to take effect in 1990.

(ii) Vancouver Island Pipeline Project

Given the uncertainty regarding the start of construction of the Vancouver Island Pipeline Project, Westcoast indicated that it had estimated its charges to PCEC based on the assumption that construction of the Vancouver Island Pipeline Project might not start in 1990. Consequently, Westcoast suggested that a deferral account be set up in which to record the difference between estimated and actual cost recoveries from PCEC in the test year.

COFI/Cominco and IPAC agreed with the establishment of a deferral account for the Vancouver Island Pipeline Project for the reasons put forward by Westcoast.

(iii) 1989 Cost of Service Deferral Account Variances

Westcoast asked for this deferral to provide for variances between estimated and actual 31 December 1989 Cost of Service deferral account balances.

Views of the Board

The Board finds reasonable Westcoast's arguments supporting the need for each of these new deferral accounts. Regarding IPAC's concerns relating to the CD Volume deferral account, the Board notes that under a fixed-forward test year that does not coincide with the gas year, Westcoast must make an estimate of CD levels and throughput for the period 1 November to 31 December of a test year. Given that so many of the current firm contracts are for one-year terms which expire on 31 October, Westcoast would be unfairly placed at risk if the Board were to deny Westcoast's request to record in a deferral account any revenue shortfall arising from a decrease in CD levels from those used to establish the tolls.

Decision

The Board approves the new deferral accounts described above.

Chapter 7

Tolls and Toll Schedules

The Board directed Westcoast to determine its 1990 test-year rate base and revenue requirement based on the Decisions set out in its 11 December 1989 Decision, as amended. The Board also directed that Westcoast determine its 1990 tolls using the revenue requirement so determined and Westcoast's best estimates of the operating demand volumes and throughput for each toll zone for the 1990 test year. Further, Westcoast was required to revise the rate base and cost of service and all supporting schedules for the 1990 test year. The revised schedules and the tolls and tariffs were filed with the Board and served on interested parties on 15 January 1990.

Chapter 8

Disposition

The foregoing chapters, together with Order TG-9-89, as amended, constitute our Reasons for Decision and our Decision on this matter.

R. B. Horner, Q.C.
Presiding Member

D. B. Smith
Member

A. Côté-Verhaaf
Member

Order TG-9-89

IN THE MATTER OF the *National Energy Board Act* ("the Act") and the regulations made thereunder; and

IN THE MATTER OF an application by Westcoast Energy Inc. ("Westcoast") dated 5 July 1989, as amended, for an order respecting its tolls and tariffs pursuant to Part IV of the Act and filed with the National Energy Board ("the Board") under File No. 1562-W5-14.

B E F O R E:

R.B. Horner
Presiding Member

D.B. Smith
Member

On Monday, the 11th day of December 1989

A. Côté-Verhaaf
Member

WHEREAS, by application dated the 5th day of July 1989, as amended, Westcoast applied to the Board for an order under Part IV of the Act fixing the just and reasonable tolls that Westcoast may charge, effective 1 November 1989, for or in respect of the transportation of gas sold by Westcoast and for the transportation of gas owned by others, and disallowing any existing tolls that are inconsistent with the just and reasonable tolls so fixed;

AND WHEREAS Westcoast has requested that the Board, by order, approve for accounting and tollmaking purposes certain related procedures and deferral accounts;

AND WHEREAS the Board has heard evidence and submissions of Westcoast and all intervenors with respect to the Phase II application at a public hearing held pursuant to Order RH-2-89, which commenced in Vancouver on 11 October 1989;

AND WHEREAS on 19 October 1989 the Board directed Westcoast to file final tolls for the period 1 November to 31 December 1989 leaving the tolls commencing 1 January 1990 to be determined at the conclusion of the RH-2-89 Phase II hearing;

AND WHEREAS the Board's decisions on the Phase II application are set out in its Decision dated 11 December 1989 and in this Order;

AND WHEREAS the Board's decisions on Westcoast's Phase I application held pursuant to Order RH-1-89 are set out in its Reason for Decision dated September 1989 and in Order TG-8-89;

IT IS ORDERED THAT:

1. Westcoast shall for accounting, tollmaking and tariff purposes, implement procedures conforming with the decisions set out in the Board's Decision dated 11 December 1989, the decisions set out in its RH-1-89 Reasons for Decision dated September 1989, Order TG-8-89, the Board's ruling of 19 October 1989 and with this Order.

2. The tolls authorized herein shall be in service and come into effect on 1 January 1990 and shall form part of Westcoast's tariffs.

3. Westcoast shall file with the Board and serve upon all intervenors to the hearing of this application, by 15 January 1990, new tariffs and tolls conforming with the decisions referred to in paragraph 1 of this Order.

4. Those provisions of Westcoast's tariffs and tolls or any portion thereof that are contrary to any provision of the Act, the Board's decisions referred to in paragraph 1 of this Order or any order of the Board, are hereby disallowed, after 31 December 1989.

THE NATIONAL ENERGY BOARD

Marie Tobin
Secretary

NATIONAL ENERGY BOARD
DECISION
WESTCOAST ENERGY INC.
RH-2-89 TOLL PROCEEDING

IN THE MATTER OF the National Energy Board Act and the Regulations made thereunder; and

IN THE MATTER OF an application by Westcoast Energy Inc. for an order respecting tolls pursuant to Part IV of the National Energy Board Act; and

IN THE MATTER OF the National Energy Board Directions on Procedure in Order RH-2-89.

HEARD in Vancouver, British Columbia on 11, 12, 13, 16, 17, 18, 19 20, 23 and 24 October, and in Ottawa, Ontario on 31 October and 1 November 1989.

BEFORE:

R.B. Horner, Q.C.
Presiding Member

D.B. Smith
Member

On Monday, the 11th day of December 1989

A. Côté-Verhaaf
Member

IN RESPECT OF the issues addressed during the RH-2-89 toll proceeding, the following constitute our decisions on these matters.

1. Background and Application

2. Revenue Requirement for 1990

   The Board directs Westcoast to determine its test-year 1990 revenue requirement taking into account the decisions set forth herein.

3. Rate Base and Depreciation

3.1 Gas Plant in Service

3.1.1 Capital Additions Transferred to Gas Plant in Service

The Board directs Westcoast to remove from its applied-for 1990 gas plant in service, the forecast amounts for those projects that have not received Board approval under Part III of the NEB Act by 11 December 1989.

3.1.2 Forecast of Test-Year Allowance for Funds Used During Construction

Westcoast is directed to calculate its forecast test-year allowance for funds used during construction to reflect the capital additions transferred to gas plant in service in accordance with the Board's decision in section 3.1.1, and the rate of return on rate base determined in accordance with the decisions set out herein.

3.1.3 Adjustment to Forecast Gas Plant in Service

The Board approves the applied-for net plant in service adjustment factor of 0.712 percent.

3.2 Grizzly Valley Tax Reassessment

The Board approves the applied-for rate base treatment in respect of the Grizzly Valley Tax Reassessment.

3.3 Pension Expense Income Tax Deferral

The Board denies Westcoast's proposed rate base treatment of the pension expense income tax deferral account balance (see also section 4.7.2).

3.4 Deferred Income Tax Adjustment

Westcoast's proposed adjustment to its deferred income tax balance is disallowed (see also section 4.7.1).

3.5 Adjustment to Working Capital

Westcoast is directed to make the necessary adjustments to its working capital provision to give effect to the Board's decisions.

3.6 Depreciation

3.6.1 New Depreciation Rates

The Board approves the applied-for depreciation rates for the transportation equipment under 5 tons, the new aircraft, and the Aitken Creek Processing Plant.

3.6.2 Depreciation Study

The Board directs Westcoast to undertake a depreciation study and to file it with the Board by 1 March 1991.

4. Cost of Capital

4.1 Funded Debt

The Board directs that the dollar amount of funded debt and the associated cost rate be determined using the "modified net proceeds" method as set out in Exhibit B-51.

4.2 Unfunded Debt

The Board finds an unfunded debt cost rate of 10.5 percent to be reasonable for the test year.

4.3 Preferred Share Capital

Consistent with its decision in section 4.1, the Board directs that the dollar amount of preferred share capital and the associated cost rate be determined using the "modified net proceeds" method as set out in Exhibit B-51.

4.4 Common Equity Ratio

The Board approves the applied-for deemed common equity ratio of 35 percent for the test year.

4.5 Rate of Return on Common Equity

The Board finds that a rate of return on common equity of 13.25 percent is fair for the 1990 test year.

4.6 Rate of Return on Rate Base

The Board directs Westcoast to determine its rate of return on rate base based on the decisions set out herein.

4.7 Income Taxes

4.7.1 Deferred Income Tax Adjustment

The Board denies Westcoast's proposal to reflect in its cost of service at this time the proposed accounting recommendations for corporate income taxes set out in the CICA Exposure Draft dated November 1988. Accordingly, the Board does not approve Westcoast's proposals to reduce its deferred income tax balance to reflect the decrease in the corporate tax rate and to amortize the amount so determined to the cost of service over a 3-year period commencing in 1990 (see also section 3.4).

4.7.2 Pension Expense Income Tax Deferral

The Board directs that the amount of the income tax associated with the non-deductible pension costs be placed in a special deferral account. Further, the Board directs that the 1990 carrying charges in respect of the balance in this account be included in the 1990 cost of service using an estimated short-term borrowing rate of 10.75 percent (see also section 3.3).

4.7.3 Income Tax Rate Change Deferral

The Board directs Westcoast to determine the amount to be deferred in respect of the income tax rate change using the approach set forth in the attachment to this Decision. Consequently, Westcoast is directed to credit the over-collection of $3,642,000 and associated carrying charges to the test year cost of service (see also section 6.1).

4.7.4 Flow-Through Tax Calculation

The Board directs Westcoast to adjust the 1990 test-year flow-through income tax provision to reflect the decisions contained herein.

5. Operating Costs

5.1 Salaries, Wages and Employee Benefits

5.1.1 Staff Complement

The Board accepts Westcoast's projected net utility staff complement for the 1990 test year.

5.1.2 Annual Rate of Increase

The Board directs Westcoast to use a 5.0 percent average increase rather than the applied-for increase of 5.5 percent in calculating its salaries, wages and benefits expense for the 1990 test year.

5.1.3 Allocation to Non-Utility

The Board accepts Westcoast's method of allocating costs to non-utility as being reasonable for the test year. However, the Board directs Westcoast to record in a separate deferral account any variance between the actual amount and the estimate included in the application in respect of the Vancouver Island Pipeline Project (see also section 6.4).

5.2 Retainer Fee

The Board directs Westcoast to increase the retainer fee to $200,000 for the 1990 test year.

5.3 Profit Contribution on Services Provided to Non-Utility Activities

The Board has decided not to alter the treatment of the 20 percent profit contribution for services provided in respect of Westcoast's Engineering, Procurement and Construction Services Agreement for the Vancouver Island Project.

5.4 Liability for Vacation Pay

The Board approves Westcoast's proposal to reflect in the cost of service vacation pay liability determined on an accrual rather than a cash basis.

5.5 Vancal Lease

The Board approves Westcoast's proposal to include in the cost of service a rental charge for the Vancouver Head Office based on the new lease agreement.

5.6 Marketing and Corporate Development Charges to Utility

The Board approves the method used by Westcoast to allocate portions of its non-utility Gas Marketing and Corporate Development expenses to utility operations.

5.7 Canadian Gas Association Costs

The Board denies Westcoast's proposal to include in its utility cost of service the full amounts of Westcoast's proposed contributions of $60,000 to the Canadian Gas Association Advertising program and of $50,000 to the Natural Gas Vehicle Research program. The Board directs that these amounts be included in Westcoast's Gas Marketing Department expenses for the 1990 test year. Consequently two-sevenths of these amounts or $31,000 will be allocated to utility operations for the test year.

5.8 NEB Cost Recovery

The Board approves the inclusion of a provision of $1,794,000 in Westcoast's cost of service in respect of the NEB Cost Recovery Program. The Board also approves Westcoast's request for a deferral account to record any differences between the provision and the actual fee levied (see also section 6.4).

5.9 Other Miscellaneous Matters

5.9.1 Calgary and Ottawa Offices

The Board finds Westcoast's rationale supporting the need for these two offices to be reasonable.

5.9.2 Industry and Association Dues

The Board approves the applied-for amount for industry and association dues.

5.9.3 Surveillance Reports

The Board has recently taken steps to improve both access to and the information provided by Westcoast and other gas pipelines in such reports.

In addition, in recognition of the increasingly complex corporate organization of Westcoast, the Board directs Westcoast to file with the Board, as part of its quarterly surveillance report, a list of all non-arms length transactions of the pipeline operation over $50,000 each and their bases of valuation. This reporting requirement commences with the first quarterly report of 1990. In this regard, Board staff will meet with the Company to determine the format of these reports.

5.9.4 Filing of Toll Applications

The Board directs Westcoast to take the necessary steps to enable it to file future toll applications not later than six months prior to the commencement of the next test year.

6. Deferral Accounts

6.1 Income Tax Rate Change Deferral

The Board directs Westcoast to adjust the deferral account balance to reflect a deferral of $3,642,000 (see also section 4.7.3).

6.2 Dispositions of Existing Deferral Accounts

The Board approves Westcoast's proposed dispositions of the balances in the revenue and expense deferral accounts.

6.3 Existing Accounts

6.3.1 Accounts to be Reinstated

The Board approves the reinstatement of the deferral accounts requested by Westcoast.

6.3.2 Accounts to be Discontinued

The Board notes that as a result of its RH-1-89 Phase I Decision, deferral accounts in respect of the following items are no longer required.

- Laprise Off-Load Project
- Authorized Overrun Revenues
- Interruptible Sales and Service Revenues
- Interruptible Transportation Storage Service Revenue - Injection
- Firm Transportation Storage Service Revenue

The Board directs that Westcoast discontinue these deferral accounts.

6.4 New Accounts

The Board approves the following new deferral accounts.

- Contract Demand Volume Variances
- 1989 Revenue Deferral Account Variances
- Vancouver Island Project
- 1989 Cost of Service Deferral Account Variances
- Pension Expense Income Tax Deferral
- NEB Cost Recovery

7. Tolls and Toll Schedules

The Board directs Westcoast to determine its 1990 test-year rate base and revenue requirement based on the foregoing decisions. The Board also directs that Westcoast determine its 1990 tolls using the revenue requirement so determined and Westcoast's best estimates of the operating demand volumes and throughput for each toll zone for the 1990 test year. Further, Westcoast is required to revise the rate base and cost of service and all supporting schedules for the 1990 test year. The revised schedules and the tolls and tariffs are to be filed with the Board and served on interested parties by 15 January 1990.

R.B.Horner, Q.C.
Presiding Member

D.B. Smith
Member

A. Côté-Verhaaf
Member

National Energy Board

Calculation of Deferral Amount re Income Tax Rate Change

	$000
Adjusted Equity Return (Income Tax Base)	31,209
Utility Income Taxes (that should have been collected at 1989 rate of 42.590%)	
$= \text{Income Tax Base} \times \dfrac{\text{Tax Rate}}{\text{1-Tax Rate}}$	
$= 31{,}209 \times \dfrac{.4259}{5741} =$	23,152
Taxable Income	54,361
Income Tax Expense = Taxable Income X Tax Rate (1989 Rate)	
= 54,361 X 42.59% =	23,152
Income Tax Expense = 58,003 X 46.195% = (1988 Rate)	26,794
Deferral - Income Tax Rate Change	**3,642**

File: 1562-W5-14

3 August 1989

VIA TELECOPIER

Mr. R.B. Maas
Vice President
Marketing and Regulatory Affairs
Westcoast Energy Inc.
1333 West Georgia Street
Vancouver, B.C.
V6E 3K9

Dear Mr. Maas:

Re: Westcoast Energy Inc. - Application for Tolls Effective 1 November 1989 - Phase II

Further to its letter of 23 March 1989 and your Phase II application and evidence dated 5 July 1989, the Board is issuing the attached Directions on Procedure for the Phase II Hearing which will commence on 11 October 1989 in Vancouver. Phase II will deal with matters relating to rate base, cost of service, rate of return and the disposition of all deferral account balances as at 31 December 1988 and for 1989. The latter item was deferred from Phase I to Phase II.

Please serve this letter and the attached Directions on Procedure No. RH-2-89 on parties as required by paragraph 13 of the Directions.

Yours truly

Louise Meagher
Secretary

Attach.

File No.: 1562-W5-14

3 August 1989

Hearing Order RH-2-89

Directions on Procedure

Westcoast Energy Inc. - Application For Tolls Effective 1 November 1989 Phase II

On 23 March 1989, the Board decided to conduct an examination of Westcoast's tolls in two phases. The Board directed Westcoast to file its Phase II application and evidence relating to rate base, cost of service and rate of return on 30 June 1989. This date was subsequently extended to 5 July 1989. Westcoast filed its Phase II application and evidence on 5 July 1989.

Phase II will commence on 11 October 1989 in Vancouver, British Columbia.

The Board directs that the procedure for the Phase II Hearing be as follows:

PUBLIC VIEWING

1. The Applicant shall deposit and keep on file, for public inspection during normal business hours, a copy of the application in its offices at 1333 West Georgia Street, Vancouver, British Columbia, V6E 3K9. A copy of the application will be available for viewing in the Board's Library, Room 962, 473 Albert Street, Ottawa, Ontario, K1A 0E5 and at the National Energy Board, 4500 - 16th Avenue, N.W., Calgary, Alberta, T3B 0M6.

SCOPE OF HEARING

2. The Phase II Hearing will deal with the issues of rate base, cost of service, rate of return and

the disposition of all deferral account balances as at 31 December 1988 and for 1989. The latter issue was deferred from Phase I to Phase II.

INTERVENTIONS

3. Interventions are required to be filed with the Secretary and served on the Applicant by 21 August 1989. Interventions should include all information set out in subsection 32(1) of the revised NEB Draft Rules of Practice and Procedure dated 21 April 1987.

4. The Secretary will issue a list of intervenors shortly thereafter.

5. Westcoast shall serve a copy of its application and evidence on all intervenors, who were not previously served, as soon as their interventions are received by Westcoast.

INFORMATION REQUESTS TO THE APPLICANT

6. Information requests addressed to the Applicant shall be filed with the Secretary and served on all parties to the proceeding by 22 August 1989.

7. Responses to the information requests made pursuant to paragraph 6 shall be filed with the Secretary and served on all parties to the proceeding by 5 September 1989.

INTERVENOR WRITTEN EVIDENCE

8. Intervenor Written Evidence shall be filed with the Secretary and served on all parties to the proceeding by 12 September 1989.

LETTERS OF COMMENT

9. Letters of comment shall be filed with the Secretary and served on Westcoast by 12 September 1989.

INFORMATION REQUESTS TO INTERVENORS

10. Information requests with respect to the material filed pursuant to paragraph 8 shall be filed with the Secretary and served on all parties to the proceeding by 22 September 1989.

11. Responses to the information requests made pursuant to paragraph 10 shall be filed with the Secretary and served on all parties to the proceeding by 2 October 1989.

HEARING

12. The Phase II Hearing will commence in Vancouver, British Columbia, on 11 October 1989 at 8:30 a.m. at the Sheraton Landmark Hotel, 1400 Robson Street.

SERVICE TO PARTIES

13. Westcoast shall serve one copy of these Directions on Procedure and the Notice of Public Hearing attached as Appendix I forthwith on all parties who intervened in the RH-1-89, Phase I toll proceeding.

NOTICE OF HEARING

14. The publications in which the Applicant is required to publish the Notice of Public Hearing are listed in Appendix II.

PROCEDURE FOR HEARING OF EVIDENCE AND FINAL ARGUMENT

15. The evidence of all parties related to the issues of rate base, cost of service and the disposition of all deferral account balances will be heard first, followed by the evidence of all parties on rate of return.

    In both cases, the following procedures shall apply:

    (a) Westcoast shall present its evidence;

    (b) intervenors and Board Counsel shall have the right to cross-examine Westcoast's witnesses;

    (c) intervenors shall present their evidence in an order to be specified at the commencement of the proceedings;

    (d) after each intervenor has presented its evidence, other intervenors, Westcoast and Board Counsel shall have the right of cross-examination; and

    (e) Westcoast may present reply evidence.

16. Following the evidentiary portion of the hearing, final argument shall be heard on all issues discussed at the hearing.

FILING AND SERVICE REQUIREMENTS

17. Where parties are directed by these Directions on Procedure or by the draft NEB *Rules of Practice and Procedure* to file with the Board or serve documents on other parties, the following number of copies shall be serve or filed, subject to paragraphs 19 and 20:

    (a) 35 copies of the document are to be filed with the Board;

    (b) 3 copies of the document are to be served on the Applicant; and

    (c) 1 copy of the document is to be served on Intervenors.

18. Persons filing letters of comment should serve one copy of the documents on Westcoast and file one copy with the Board, which in turn will provide copies for all other parties.

19. Parties filing or serving documents fewer than five days before the commencement of the hearing shall, in addition to the requirements set out in Paragraph 17, bring to the hearing sufficient copies for use by the Board and other parties present at the hearing.

20. Parties filing or serving documents at the hearing shall file or serve sufficient copies for use by the Board and other parties present at the hearing.

SIMULTANEOUS INTERPRETATION

21. If it appears that both official languages will be used at the hearing, simultaneous interpretation will be provided.

GENERAL

22. Unless otherwise directed by the Board, the hours of sitting shall be from 8:30 a.m. to 1:00 p.m.

23. All parties are asked to quote Order No. RH-2-89 and file No. 1562-W5-14 when corresponding with the Board in this matter.

24. Subject to the foregoing, the procedures to be followed in this proceeding shall be governed by the National Energy Board Draft *Rules of Practice and Procedure* dated 21 April 1987.

25. For information on this hearing, or the procedures governing the hearing, contact Ms. Kathy Pope, Regulatory Support Officer, at (613) 990-3156.

NATIONAL ENERGY BOARD

Louise Meagher
Secretary

Appendix I

NATIONAL ENERGY BOARD

NOTICE OF PUBLIC HEARING

**Westcoast Energy Inc. -
Phase II Toll Proceeding**

On 23 March 1989 the Board decided to hold a two-phased public examination of Westcoast's tolls pursuant to Part IV of the National Energy Board Act. Phase I which was held from 12 June to 18 July 1989 examined toll design and tariff matters, including Westcoast's proposed capacity allocation policy.

Phase II, which will deal with rate base, cost of service, rate of return matters and the disposition of all deferral account balances, will commence in Vancouver, British Columbia on 11 October 1989 at 8:30 a.m. at the Sheraton Landmark Hotel, 1400 Robson Street.

Anyone wishing to intervene in Phase II will be required to file a written intervention with the Secretary of the Board and serve a copy on Westcoast at the following address by 21 August 1989. The Secretary will then issue a list of intervenors.

Mr. R.B. Maas
Vice President
Marketing and Regulatory Affairs
Westcoast Energy Inc.
1333 West Georgia Street
Vancouver, British Columbia
V6E 3K9
Telecopier: (604) 664-5702

Westcoast filed its Phase II application and evidence with the Board on 5 July 1989 and served it on all intervenors to the RH-1-89 Phase I toll proceeding. Westcoast will provide a copy of all relevant material to any intervenor not previously served with the Phase II material as soon as possible after receipt of the intervention.

Anyone wishing only to comment on Phase II matters should write to the Secretary of the Board and send a copy to Westcoast by 12 September 1989.

Information on the procedures for this examination or the revised Draft *NEB Rules of Practice and Procedure* governing all hearings (available in English and French) may be obtained by writing to the Secretary or telephoning the Board's Regulatory Support Office at (613) 998-7204.

Louise Meagher
Secretary
National Energy Board
473 Albert Street
Ottawa, Ontario
K1A 0E5
Telex: 0533791
Telecopier: (613) 990-7900

Appendix II

Publications	City
"Times Colonist"	Victoria, British Columbia
"The Sun", the "Vancouver Province" & "Le Soleil de Colombie"	Vancouver, B.C.
"Alaska Highway News"	Fort St. John, B.C.
"The Edmonton Journal" & "Le Franco-albertain"	Edmonton, Alberta
"Calgary Herald"	Calgary, Alberta
"Globe and Mail" and "The Financial Post"	Toronto, Ontario
"Canada Gazette" and "The Citizen"	Ottawa, Ontario

WESTCOAST ENERGY INC.

RH-2-89

Board Ruling from the Bench
19 October 1989

Having considered the comments of Interested Parties with respect to the Board's proposed method of determining tolls for the period 1 November to 31 December 1989, the Board directs Westcoast to determine final tolls for this period in the following manner:

(1) The revenue requirement for toll-making purposes for the period 1 November to 31 December 1989 shall be determined by deducting from the 1989 approved revenue requirement of $274.5 million, the estimate of the toll revenue that Westcoast will collect under the existing approved tolls for the period 1 January to 31 October 1989.

(2) The tolls for November and December shall be struck based on the revenue requirement as determined in the manner set out in paragraph (1) and the operating demand volumes for each toll zone as at 1 November 1989. The tolls shall also reflect the toll design changes set out in the Board's RH-1-89 Reasons for Decision.

The Board further directs Westcoast to maintain the approved 1989 Revenue Deferral Account to record any variances between the actual toll revenue received by Westcoast in 1989 and the approved revenue requirement of $274.5 million. The balance in this deferral account will be disposed of at the next Westcoast toll hearing.

Finally, the Board directs that, effective 1 November 1989, Westcoast shall cease to record any further revenue in the following revenue deferral accounts:

(1) Interruptible storage service injection;

(2) Firm transportation storage service; and

(3) Laprise Offload Project

Westcoast shall, by 15 November 1989, file with the Board and serve on all shippers and all Interested Parties to the RH-1-89 and RH-2-89 Westcoast toll proceedings the new tolls and toll schedules conforming with this decision.

Those provisions of Westcoast's tariffs and tolls or any portion thereof that are contrary to the RH-1-89 Reasons for Decision and this decision are disallowed as of 1 November 1989.

Westcoast Energy Inc.
1333 West Georgia Street
Vancouver, British Columbia
V6E 3K9
Telephone (604) 664-5854
Telex 04-51340
FAX (604) 664-5702

R. B. Maas
Vice President,
Marketing and Regulatory Affairs

December 22, 1989

Via Fax

National Energy Board
473 Albert Street
Ottawa, Ontario
K1A OE5

Attention: **Ms. Marie Tobin**
Secretary

Dear Sirs:

Re: **National Energy Board Decision**
Westcoast Energy Inc. RH-2-89 Toll Proceeding

In the Board's Decision the amount of the deferral in Section 6.1 applied to reduce the 1990 revenue requirement is $3,642,000. The Company wishes to inform the Board that the actual excess revenue collected was in fact $2,091,000. It was unfortunate that the amount of $2,091,000 was erroneously characterized as reflecting a change in the tax rate in 1988 and 1989 rather than a deferral of excess revenue. As the Board, in its Decision, required a credit of $3,642,000 against the 1990 revenue requirement there is now a deficiency of $1,551,000 in the Company's 1990 cost of service recovery.

In order to keep the Company whole, Westcoast respectfully requests the Board to amend Sections 4.7.3 (p.4) and 6.1 (p.6) of its Decision to reflect the amount of $2,091,000 as being the refund to be made in 1990.

Yours truly,

R. B. Maas

cc: Interested Parties
pursuant to RH-2-89

File: 1562-W5-14

28 December 1989

Mr. R.B. Maas
Vice-President
Marketing and Regulatory Affairs
Westcoast Energy Inc.
1333 West Georgia Street
Vancouver, British Columbia
V6E 3K9

Dear Mr. Maas:

Re: Westcoast Energy Inc. Application to amend the National Energy Board Decision in respect of the Westcoast Energy Inc. RH-2-89 Toll Proceeding

The Board is currently reviewing Westcoast's request as set out in your letter dated 22 December 1989. As a decision on this matter will not be reached until after 1 January 1990, the Board has decided that Westcoast should continue to charge the existing tolls on an interim basis pending the Board's final decision. A copy of interim order TGI-4-89 is attached.

Interested parties shall have until 8 January 1990 to file with the Board and to serve on Westcoast, a copy of their comments concerning Westcoast's application.

Westcoast shall have until 10 January 1990 to file its reply with the Board and serve a copy on the interested parties who commented on the application.

Westcoast is directed to serve a copy of this letter and the interim order on the interested parties to the RH-2-89 toll proceeding by 2 January 1990.

Yours truly,

Marie Tobin
Secretary

Order TGI-4-89

IN THE MATTER OF the *National Energy Board Act* ("the Act") and the regulations made thereunder; and

IN THE MATTER OF an application dated 22 December 1989, by Westcoast Energy Inc. ("Westcoast") for an order respecting its tolls and tariffs pursuant to Part IV of the Act and filed with the National Energy Board ("the Board") under File 1562-W5-14.

B E F O R E the Board on Thursday the 28th day of December, 1989.

WHEREAS on 19 December 1989 the Board issued its decision with respect to Westcoast's Phase II toll application which was heard pursuant to Hearing Order RH-2-89;

AND WHEREAS by Order TG-9-89 the Board approved, effective 1 January 1990, tolls on the Westcoast system resulting from its RH-2-89 decision;

AND WHEREAS by letter dated 22 December 1989, Westcoast applied to the Board requesting an amendment to certain aspects of that decision which would affect the resulting tolls;

AND WHEREAS the Board's consideration of Westcoast's application will not be completed until after 1 January 1990;

AND WHEREAS the Board finds it appropriate that the existing tolls continue to be charged on an interim basis pending the Board's final decision on Westcoast's application;

IT IS ORDERED THAT:

1. Pursuant to subsection 19(2) and section 59 of the Act, the existing tolls are to be charged on an interim basis for the period commencing

1 January 1990 and will remain in effect until the day before the Board's final order on Westcoast's application comes into effect.

2. Order TG-9-89 is hereby suspended until otherwise directed by the Board.

THE NATIONAL ENERGY BOARD

Marie Tobin
Secretary

File: 1562-W5-14

9 January 1990

Mr. R. B. Maas
Vice-President
Marketing & Regulatory Affairs
Westcoast Energy Inc.
1333 West Georgia Street
Vancouver, B. C.
V6E 3K9

Dear Mr. Maas:

Re: National Energy Board Decision
Westcoast Energy Inc. RH-2-89
Toll Proceeding

The Board has considered Westcoast's application of 22 December 1989 concerning aspects of the Board's 11 December 1989 RH-2-89 Decision. Based on facts brought to the Board's attention by Westcoast subsequent to the release of its Decision on 19 December 1989, the Board considers it necessary to amend sections 4.7.3 and 6.1 of that Decision.

In its letter of 22 December 1989, Westcoast stated that it was unfortunate that the amount in question had been erroneously characterized by it as reflecting a change in the tax rate in 1988 and 1989 rather than a deferral of excess revenue. Westcoast indicated that the actual excess revenue collected from the tollpayers was $2,091,000 and not the amount of $3,642,000 referred to in sections 4.7.3 and 6.1 of the Board's decision.

Before reaching a decision on this matter, the Board sought the views of interested parties to the toll proceeding. The Canadian Petroleum Association and the British Columbia Petroleum Corporation have informed the Board that they agree with Westcoast on this matter.

The Board is satisfied that the amount to be deferred should be $2,091,000 plus carrying charges as this amount reflects the true nature of the deferral, i.e. a deferral of excess revenue. Accordingly, the amount of $3,642,000 referred to in sections 4.7.3 and 6.1 of the Decision should be deleted and the amount of $2,091,000 substituted therefor. Attached is amending Order A0-1-TG-9-89, which incorporates the above decision and reinstates Order TG-9-89.

Westcoast is directed to serve a copy of this letter and amending Order A0-1-TG-9-89 on interested parties to the RH-2-89 toll proceeding as soon as possible.

Yours truly,

Marie Tobin
Secretary

Attach.

AO-1-TG-9-89

IN THE MATTER OF the *National Energy Board Act* ("the Act") and the Regulations made thereunder; and

IN THE MATTER OF an application by Westcoast Energy Inc. (Westcoast) dated 5 July 1989, as amended, for an order respecting its tolls and tariffs pursuant to Part IV of the Act and filed with the National Energy Board ("the Board") under file 1562-W5-14.

B E F O R E:

R.B. Horner, Q.C.
Presiding Member

D.B. Smith
Member

On Tuesday, the 9th day of January 1990

A. Côté-Verhaaf
Member

WHEREAS, by Order TG-9-89, the Board approved, effective 1 January 1990, certain tolls on the Westcoast system resulting from the Board's RH-2-89 Decision dated 11 December 1989;

AND WHEREAS by letter dated 22 December 1989, Westcoast applied to the Board to amend certain aspects of the Board's RH-2-89 Decision;

AND WHEREAS the Board issued Order TGI-4-89 suspending Order TG-9-89 and making Westcoast's existing tolls interim commencing 1 January 1990 until the Board's final decision on Westcoast's application comes into affect;

AND WHEREAS the Board considered the application and the comments of interested parties and found it appropriate to amend the RH-2-89 Decision and Order TG-9-89;

AND WHEREAS by letter dated 9 January 1990 the Board made its final decision on the application and amended the RH-2-89 Decision;

IT IS ORDERED THAT:

1. Order TG-9-89 which was suspended is hereby reinstated.

2. Paragraph 1 of Order TG-9-89 is hereby revoked and the following substituted therefor:

   "1. Westcoast shall for accounting, tollmaking and tariff purposes, implement procedures conforming with the decision set out in the Board's Decision dated 11 December 1989, as amended by the Board's letter to Westcoast dated 9 January 1990, the decisions set out in its RH-1-89 Reasons for Decision dated September 1989, Order TG-8-89, the Board's ruling of 19 October 1989 and with this Order."

NATIONAL ENERGY BOARD

Marie Tobin
Secretary